State Net Operating Losses:
Understanding the Rules & Maximizing the Benefits

58th TEI Annual Upstate New York Tax Conference

Tuesday, May 9, 2017
Key challenges in the State NOL area
Understanding the mechanics of State NOLs
Strategies to monetize NOLs
Impacts of Federal Tax Reform Plans
Q&A
Key challenges for state NOLs

- States don’t follow federal NOL rules
- States differ on how to compute and use NOLs
- State NOL rules change from year to year
- Reporting on a group basis frequently means tracking NOLs by entity
- Some states allow sharing of losses and some do not
- Most states require modifications, limitations, suspensions, or other adjustments to NOLs
- Proper management of the NOL asset mitigates cash tax impacts and increases earnings per share
Current approach to managing NOLs

• Most create their own spreadsheets
  • Time invested to research and keep up with the changing NOL rules
  • Resources needed with Excel skills to program complex, related computations across entities and states
  • Risks of broken links
  • Lack of audit trail & permissions control
  • Increasingly coming under scrutiny of internal and external auditors
  • Understood by one or only a few people (what if creator leaves or retires?)

• Most then retype those numbers into:
  • Compliance & Provision systems
  • Other Excel workbooks to support provision, cash tax planning, etc.
Questions You Should be Asking

• How do we maximize the tax / cash value of state NOLs in the year they are generated?

• How do we maximize NOL utilization in carryforward years and utilize a large NOL before it expires?

• How do we increase the opportunity to share NOLs between members of a combined return?

• How do we maximize the use of pre-merger NOLs?

• How do we plan???
Leveraging State NOLs

- Understand mechanics of NOL computation in year of generation & utilization
- Know the apportionment facts for each entity & any existing strategies in place across the states
- Have an inventory of the NOL generation & utilization
  - Acquired – 382/SRLY
  - Home grown
- Know Federal NOL situation & how translates to each state
- What is your motivation?
  - Manage ETR?
  - Tax Cash Benefit?
  - Both?
Basic Concepts

• Federal Taxable Income (Loss) – Form 1120 Lines 28, 29a, 29b
• State’s treatment of Federal NOL
  • Pre-apportionment NOL
  • Post-apportionment NOL
• Apportionment factor in year of generation vs utilization
• Net Add modifications (NAMs)
• State’s rules on grouping
  • To compute state taxable income vs NOL
  • Share vs no share
• Entity changes – M&A – 382/SRLY
• State’s NOL rules – c/o, c/b, limitations, suspensions, etc.
State Treatment of Federal NOL

• **16 states add-back Federal NOL**
• **25 states start with Line 28 FTI before NOL**
• **Some states modify Federal NOL**
  • Delaware uses federal NOL deduction (with limitation)
    • Limits NOL carryback to $30,000; balance may be carried-forward
  • Maryland uses federal NOL with potential modification
    • May require NOL recapture of excess of additions over subtractions from year NOL incurred when NOL is claimed
  • Missouri
    • May require modification to NOL through state additions or subtractions
  • Vermont (prior to 2007)
  • Virginia (requires adjustments)
    • Requires adjustments for state additions and subtractions from year NOL incurred
Carryback & Carryover Rules

- **Carryback**
  - 29 States do not allow NOL carrybacks
  - 3 States allow NOLs to be carried back 3 years
  - 13 States allow NOL carrybacks to same extent as federal law or allow NOLs to be carried back 2 years

- **Carryforward**
  - Approximately 26 States allow NOLs to be carried forward 15 or 20 years
  - 3 States allow NOLs to be carried forward 5 or 7 years
  - 5 States allow NOLs to be carried forward 10 or 12 years
  - 11 States allow NOLs to be carried forward to same extent as federal law

Above is generalized over the past 2 decades
Post-Apportionment Rules

• Majority of states (36 plus DC)
  • Calculate state NOL based on apportionment percentage in year NOL incurred
• Includes:
  • Massachusetts (2009+; combined groups); (2010+; separate return filers and S corporations)
  • New York (2015+)
  • Vermont (2007+)
Pre-Apportionment Rules

Less than a dozen (11) states calculate state NOL based on apportionment percentage in year NOL used – includes:

- Delaware
- Kentucky
- Maryland
- Massachusetts (before 2009 combined groups; before 2010 separate return filers and S corporations)
- Missouri
- New Jersey
- New Mexico
- New York (before 2015)
- Rhode Island
- Vermont (before 2007)
- Virginia
Group Reporting

- Combined or Consolidated Reporting
  - 28 states plus the District of Columbia allow or require combined reporting
  - 24 states that have default filing method of separate reporting or combined also allow elective consolidation
    - (note: Kentucky requires mandatory nexus consolidation)

- Combining Group Income
  - The majority of combined reporting states combine group members income on a group apportionment basis
  - Mississippi and Virginia combined return (consolidated return in other states) combines group members income on a 'stacked' entity-by-entity apportionment basis
Group Reporting Complicates NOLs

- **Group-Post:** Most states combine incomes on a group basis and then calculate and track NOLs on a post-apportionment basis.

- **Group-Pre:** Group basis for income, but NOLs on pre-apportionment. Kentucky, Missouri, New Mexico, Rhode Island, and Virginia consolidated return (combined returns in other states).

- **Stacked-Entity-Post:** Mississippi.

- **Stacked-Entity-Pre:** Virginia combined return (consolidated return in other states).

- **Intrastate:** California uses group based apportionment to compute the generated income/loss, but in NOL area, when it’s time to utilize an NOL, each entity must track its own NOL – there is no sharing of losses.
Sharing vs No Sharing

• **Current Year Losses**
  • States generally allow current year losses to be shared among group members **without limitation**
  • **Exception**: Kentucky (consolidated return) limits NOLs to 50% of income realized by remaining affiliated members that did not realize NOLs

• **Carrybacks and Carryforwards**
  • Combined returns
    • 15 states allow sharing among group members that were part of the original loss year return
    • 11 states plus District of Columbia do not allow sharing; only allow NOL c/b or c/f to be claimed by member that incurred the NOL
  • Consolidated returns - majority of states have SRLY rules
Limitations on Sharing

• Examples:
  • Wisconsin – limits sharing of pre-2009 NOL carryforwards related to separate reporting (combined reporting started in 2009)
    • Tax years before 2012: no sharing of pre-2009 NOL carryforwards with group
    • Tax years after 2011: apply NOL carryforward to member’s own income, then apply 5% of NOL c/f to other members
  • Rhode Island – proposed regulations do not allow pre-2015 NOL carryforwards to be shared among members of a combined return (combined reporting started in 2015)
Limitations, Suspensions, NAMs

Examples

- **California** - Phased in 2-year carryback period
  - Limited NOL carrybacks for NOLs incurred in:
    - Tax years beginning on or after January 1, 2013 and before January 1, 2014 to 50% of NOL incurred
    - Tax years beginning on or after January 1, 2014 to 75% of NOL incurred
- **Illinois** - Limited NOL carryover deduction to $100,000 per tax year for tax years ending after December 31, 2012 and prior to December 31, 2014
- **Delaware** (permanent limitation)
  - Does not have a state NOL / Utilizes federal NOL deduction
  - Limits NOL carrybacks to only $30,000; remaining balance of NOL is carried forward
### Group Return *Post-Apportionment*

![Bloomberg BNA BNA State Tax Analyzer](image)

<table>
<thead>
<tr>
<th>Scenario details</th>
<th>Arizona</th>
<th>ABC Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>State</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entity/Group</td>
<td></td>
<td>ABC Group</td>
</tr>
<tr>
<td>Period begin</td>
<td>1/1/2015</td>
<td></td>
</tr>
<tr>
<td>Period end</td>
<td>12/31/2015</td>
<td></td>
</tr>
<tr>
<td>Scenario</td>
<td>Group-Post States</td>
<td></td>
</tr>
<tr>
<td>Apportionment calculation method</td>
<td>Group</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Entity A</th>
<th>Entity B</th>
<th>Entity C</th>
</tr>
</thead>
<tbody>
<tr>
<td>State subtractions total</td>
<td>175,000</td>
<td>100,000</td>
<td>60,000</td>
<td>25,000</td>
</tr>
<tr>
<td>FTI adjusted to state basis</td>
<td>(59,950,000)</td>
<td>(29,950,000)</td>
<td>(9,950,000)</td>
<td>(19,950,000)</td>
</tr>
<tr>
<td>State allocated income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nonbusiness interest</td>
<td>1,050,000</td>
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<td>Nonbusiness royalties</td>
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<td></td>
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<tr>
<td>Other</td>
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<tr>
<td>Less state allocated income total</td>
<td>1,050,000</td>
<td>1,000,000</td>
<td>0</td>
<td>50,000</td>
</tr>
<tr>
<td>State income subject to apportionment</td>
<td>(50,940,000)</td>
<td>(30,950,000)</td>
<td>(9,950,000)</td>
<td>(20,000,000)</td>
</tr>
<tr>
<td>Apportionment factor %</td>
<td>0.000000%</td>
<td>5.000000%</td>
<td>2.500000%</td>
<td>3.333300%</td>
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<tr>
<td>Apportioned state income total</td>
<td>0</td>
<td>(3,047,000)</td>
<td>(1,523,500)</td>
<td>(3,031,313)</td>
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<tr>
<td>Add state specific allocated income total</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>STI/(loss) before post-apportionment NOL</td>
<td>0</td>
<td>(3,047,000)</td>
<td>(1,523,500)</td>
<td>(2,313,313)</td>
</tr>
<tr>
<td>STI/(loss) for post-apportionment NOL</td>
<td>(6,661,813)</td>
<td></td>
<td></td>
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</table>

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NOL on Post-Apportionment Basis
### Group Return Pre-Apportionment

**Bloomberg BNA BNA State Tax Analyzer**

#### Project 3 - Analysis: Tax calculation Scenario: Group-Pre States - NM

<table>
<thead>
<tr>
<th>Scenario details</th>
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<tbody>
<tr>
<td>State</td>
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<tr>
<td>Entity/Group</td>
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<tr>
<td>Period begin</td>
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<td></td>
<td></td>
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<tr>
<td>Period end</td>
<td>12/31/2015</td>
<td></td>
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</tr>
<tr>
<td>Scenario</td>
<td>Group-Pre States - NM</td>
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<td></td>
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</table>

#### Apportionment calculation method: Group

<table>
<thead>
<tr>
<th>Entity A</th>
<th>Entity B</th>
<th>Entity C</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FTI to use in this state</td>
<td>(50,000,000)</td>
<td>(30,000,000)</td>
</tr>
<tr>
<td>FTI adjustments total</td>
<td>25,000</td>
<td>60,000</td>
</tr>
<tr>
<td>FTI as adjusted</td>
<td>(59,975,000)</td>
<td>(30,065,000)</td>
</tr>
<tr>
<td>Less pre-apportionment NOL</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>State additions total</td>
<td>250,000</td>
<td>200,000</td>
</tr>
<tr>
<td>State subtractions total</td>
<td>175,000</td>
<td>100,000</td>
</tr>
<tr>
<td>FTI adjusted to state basis</td>
<td>(59,890,000)</td>
<td>(29,960,000)</td>
</tr>
<tr>
<td>Less state allocated income total</td>
<td>1,050,000</td>
<td>1,000,000</td>
</tr>
<tr>
<td>State income subject to apportionment</td>
<td>(60,940,000)</td>
<td>(30,960,000)</td>
</tr>
<tr>
<td>Apportionment factor %</td>
<td>0.000000%</td>
<td>5.000000%</td>
</tr>
<tr>
<td>Apportioned state income total</td>
<td>0</td>
<td>(3,047,000)</td>
</tr>
</tbody>
</table>

**NOL on Pre-Apportionment Basis**

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Stacked Return *Post-Apportionment*

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### BNA State Tax® Analyzer

<table>
<thead>
<tr>
<th>Project 3 - Analysis: Tax calculation - Scenario: Stacked-Post States</th>
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<tbody>
<tr>
<td><strong>Entity</strong></td>
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<td><strong>Total</strong></td>
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<tr>
<td>STI/(loss) before post-apportionment NOL</td>
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<td>STI/(loss) for post-apportionment NOL</td>
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<tr>
<td>Less state allocated income total</td>
</tr>
<tr>
<td>State income subject to apportionment</td>
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<tr>
<td>Apportionment factor %</td>
</tr>
<tr>
<td>State income before apportionment</td>
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<tr>
<td>Add state specific allocated income total</td>
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NOL on Post-Apportionment Basis

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### Stacked Return *Pre-Apportionment*

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<tr>
<td>Period/Group</td>
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<td>ABC Group</td>
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<td>Period end</td>
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</tr>
<tr>
<td>Scenario</td>
<td>□ Stacked-Pre States</td>
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#### Apportionment Calculation Method - By Entity

<table>
<thead>
<tr>
<th></th>
<th>Entity</th>
<th>Entity A</th>
<th>Entity B</th>
<th>Entity C</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FTI to use in this state</strong></td>
<td>(60,000,000)</td>
<td>(30,000,000)</td>
<td>(10,000,000)</td>
<td>(20,000,000)</td>
</tr>
<tr>
<td>FTI adjustments total</td>
<td>25,000</td>
<td>50,000</td>
<td>50,000</td>
<td>25,000</td>
</tr>
<tr>
<td>FTI as adjusted</td>
<td>(59,975,000)</td>
<td>(30,050,000)</td>
<td>(9,950,000)</td>
<td>(19,975,000)</td>
</tr>
<tr>
<td>Less pre-apportionment NOL</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State additions total</td>
<td>260,000</td>
<td>200,000</td>
<td>10,000</td>
<td>50,000</td>
</tr>
<tr>
<td>State subtractions total</td>
<td>175,000</td>
<td>100,000</td>
<td>50,000</td>
<td>25,000</td>
</tr>
<tr>
<td>FTI adjusted to state basis</td>
<td>(58,890,000)</td>
<td>(29,960,000)</td>
<td>(9,990,000)</td>
<td>(19,960,000)</td>
</tr>
<tr>
<td>Less state allocated income total</td>
<td>1,050,000</td>
<td>1,000,000</td>
<td>0</td>
<td>50,000</td>
</tr>
<tr>
<td>State income subject to apportionment</td>
<td>(60,940,000)</td>
<td>(30,960,000)</td>
<td>(9,990,000)</td>
<td>(20,000,000)</td>
</tr>
<tr>
<td>Apportionment factor %</td>
<td>15,000000%</td>
<td>7,500000%</td>
<td>10,000000%</td>
<td></td>
</tr>
<tr>
<td>Apportioned state income total</td>
<td>(7,391,750)</td>
<td>(4,642,500)</td>
<td>(749,250)</td>
<td>(2,000,000)</td>
</tr>
</tbody>
</table>
Sharing/No Sharing Examples
AZ allows sharing of NOL c/b, c/o
### Group NOL Tracking Schedule

#### Example 1

| Project 3 - Analysis: NOL calculation - ABC Group - AZ - Edit |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| NOL schedule details | | | | | | | | | |
| - Name: ABC Group - AZ (Group) | | | | | | | | | |
| - State: Arizona | | | | | | | | | |
| - NOL calculation method: Post | | | | | | | | | |
| Scenario | Group | Period begin | 1/1/2013 | 1/1/2014 | 1/1/2015 | 1/1/2016 | 1/1/2017 | 1/1/2018 |
| Group | ABC Group | | | | | | | | |
| Period end | 12/31/2013 | 12/31/2014 | 12/31/2015 | 12/31/2016 | 12/31/2017 |
| Tax year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| NOL rules | | | | | | | | |
| - Carryback | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| - Carryforward | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| - NOL calculation method | Post | Post | Post | Post | Post | Post | Post | Post |
| - Option to waive carryback? available? | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Scenario details | | | | | | | | |
| - State income/(loss) for NOL | 500,000 | 1,500,000 | (6,601,813) | 1,000,000 | 2,000,000 | 0 | 0 | 0 |
| - NOL adjustments/limitations | | | | | | | | |
| - Waive carryback? | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| - Dividends not in add/subt above | | | | | | | | |
| - Other | | | | | | | | |
| - State income/(loss) after adjustments | 500,000 | 1,500,000 | (6,601,813) | 1,000,000 | 2,000,000 | 0 | 0 | 0 |
| NOL utilization schedule | | | | | | | | |
| - 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| NOL utilization | | | | | | |
| - Carryback from this year utilized | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| - NOL available for carryforward | 0 | 0 | 0 | (6,601,813) | 0 | 0 | 0 | 0 |
| - Carryforward from this year utilized | 0 | 0 | 0 | (3,090,000) | 0 | 0 | 0 | 0 |
| Total NOL utilized | 0 | 0 | 3,090,000 | 0 | 0 | 0 | 0 | 0 |
| NOLs available for utilization in future years | | | | | | |
| - 0 | 0 | (6,601,813) | (3,601,813) | (3,601,813) | (3,601,813) | (3,601,813) | (3,601,813) | (3,601,813) |
| NOL expiration year | 2033 | 2034 | 2035 | 2036 | 2037 | 0 | 0 | 0 |
| Amount expiring | 0 | 0 | 3,601,813 | 0 | 0 | 0 | 0 | 0 |
| Less NOLs allowed – computed | 0 | 0 | 3,601,813 | 0 | 0 | 0 | 0 | 0 |
| Less NOLs allowed – scenario | 0 | 0 | 3,601,813 | 0 | 0 | 0 | 0 | 0 |
| Update all | | | | | | | | |

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Example 1

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### NOL Remaining with Expiration

**Example 1**

![Image of Bloomberg BNA BNA State Tax Analyzer](image)

<table>
<thead>
<tr>
<th>NOL Available for Utilization in Future Years</th>
<th>Expiration Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carryback from this year utilized</td>
<td>0</td>
</tr>
<tr>
<td>NOL available for carryforward</td>
<td>0</td>
</tr>
<tr>
<td>Carryforward from this year utilized</td>
<td>0</td>
</tr>
<tr>
<td>Total NOL utilized</td>
<td>3,000,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>NOLs available – computed</th>
<th>Amount expiring</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>0</td>
<td>3,601,813</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>NOL expiration year</th>
<th>NOL expiration year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2033</td>
<td>2034</td>
</tr>
<tr>
<td>2035</td>
<td>2036</td>
</tr>
<tr>
<td>2037</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Less NOLs allowed – computed</th>
<th>Update all</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>0</td>
<td>1,000,000</td>
</tr>
<tr>
<td>0</td>
<td>2,000,000</td>
</tr>
</tbody>
</table>

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### Group-Post No Sharing

#### Example 2

![Bloomberg BNA BNA State Tax Analyzer](image)

**Project 3**

**Analysis: Tax calculation**

- **Scenario details**
  - State: District of Columbia
  - Entity/Group: ABC Group
  - Period begin: 1/1/2015
  - Period end: 12/31/2015
  - Scenario: Group-Post States - DC

**Apportionment calculation method**

<table>
<thead>
<tr>
<th>Total</th>
<th>Entity A</th>
<th>Entity B</th>
<th>Entity C</th>
</tr>
</thead>
<tbody>
<tr>
<td>(60,000,000)</td>
<td>(30,000,000)</td>
<td>(10,000,000)</td>
<td>(20,000,000)</td>
</tr>
<tr>
<td>25,000</td>
<td>50,000</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>(59,975,000)</td>
<td>(30,059,000)</td>
<td>(9,950,000)</td>
<td>(19,975,000)</td>
</tr>
</tbody>
</table>

- Less pre-apportionment NOL
  - State additions total: 250,000
  - State subtractions total: 175,000
- State tax income subject to apportionment:
  - (60,940,000) | (30,950,000) | (9,990,000) | (20,000,000) |
- State tax income subject to apportionment factor %
  - 0.000000%
- Appor tioned state income total:
  - 0 | 0 | 0 |
- State tax liability total:
  - 0 | 0 | 0 |
- State taxable income(loss):
  - 0
- State tax rate/graduated effective rate:
  - 0.0000
- State tax liability total:
  - 0 | 0 | 0
- State tax liability total:
  - 0 | 0 | 0
- Payment due(overpayment):
  - 0
Group NOL Tracking Schedule

Example 2

Bloomberg BNA  BNA State Tax® Analyzer

Project 3  Analysis: NOL calculation  Entity A - DC  Edit

NOL schedule details
- Name: Entity A - DC (Entity)
- State: District of Columbia
- NOL calculation method: Post

Scenario
- Entity: Group Post States - DC
- Entity A
- Period begin:
  - 1/1/2014
  - 1/1/2015
  - 1/1/2016
  - 1/1/2017
  - 1/1/2018
- Period end:
  - 12/31/2014
  - 12/31/2015
  - 12/31/2016
  - 12/31/2017
  - 12/31/2018
  - 12/31/2019
- Tax year:
  - 2014
  - 2015
  - 2016
  - 2017
  - 2018
  - 2019

NOL rules
- Carryback: 0 0 0 0 0 0
- Carryforward: 20 20 20 20 20 20
- NOL calculation method: Post Post Post Post Post Post
- Option to waive carryback available? N/A N/A N/A N/A N/A N/A

Scenario details
- State income/(loss) for NOL:
  - 1,500,000
  - (3,047,000)
  - 1,000,000
  - 2,000,000

NOL adjustments/limitations
- Wave carryback? N/A N/A N/A N/A N/A N/A
- Dividends not in added/sub above Other
- State income/(loss) after adjustments:
  - 1,500,000
  - (3,047,000)
  - 1,000,000
  - 2,000,000

NOL utilization schedule
- Carryback from this year utilized:
  - 0 0 0 0 0 0
- NOL available for carryforward:
  - 0 (3,047,000) 0 0 0 0
- NOL available from carryforward:
  - 0 (3,047,000) 0 0 0 0
- Total NOL utilized:
  - 0 3,047,000 0 0 0 0
- NOLs available for utilization in future years:
  - 0 (47,000) (47,000) (47,000) (47,000)
- NOL expiration year:
  - 2034 2035 2036 2037 2038
- Amount expiring:
  - 0 47,000 0 0 0
- Less NOLs allowed — computed:
  - 0 0 1,000,000 2,000,000 0
- Less NOLs allowed — scenario

Update all

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### NOL Utilization

#### Example 2

![Image of NOL schedule details]

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Entity</th>
<th>Period begin</th>
<th>Period end</th>
<th>Tax year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Entity A - DC (Entity)</td>
<td>1/1/2014</td>
<td>12/31/2014</td>
<td>2014</td>
</tr>
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</table>

- **2014**: 
  - NOL calculation method: Post

- **Group-Post States - DC**: 
  - Entity A

<table>
<thead>
<tr>
<th>Year</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
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<td>NOL calculation details</td>
<td>-3,000,000</td>
<td>1,000,000</td>
<td>1,000,000</td>
<td>2,000,000</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

- **NOL utilization**:

  - Carryback from this year utilized: 0
  - NOL available for refund: 0

---

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NOL Remaining with Expiration

Example 2

[Bloomberg BNA BNA State Tax Analyzer]

Project 3 - Analyst: NOL calculation - Entity A - DC - Edit

NOL schedule details
- Name: Entity A - DC (Entity)
- State: District of Columbia
- NOL calculation method: Post
- Scenario: Group-Post States - DC
- Entity
  - Period begin: 1/1/2014, 1/1/2015, 1/1/2016, 1/1/2017, 1/1/2018
  - Period end: 12/31/2014, 12/31/2015, 12/31/2016, 12/31/2017, 12/31/2018

NOL rules
- Carryback: 0, 0, 0, 0, 0
- Carryforward: 20, 20, 20, 20
- NOL calculation method: Post, Post, Post
- Option to waive carryback available? N/A, N/A, N/A

Scenario details
- State income(loss) for NOL: 1,500,000, (3,047,000), 1,000,000, 2,000,000
- NOL adjustments/limitations
  - Waive carryback: N/A
  - Dividends not in ads/sub subject to N/A
  - Other
    - State income(loss) after adjustments: 1,500,000, (3,047,000), 1,000,000, 2,000,000

NOL utilization schedule
- 2014: 0, 0, 0, 0
- 2015: 0, 0, 0
- 2016: 0, 0, 0
- 2017: 0, 0, 0
- 2018: 0, 0, 0
- 2019: 0, 0

NOL utilization
- Carryback from this year utilized: 0, 0, 0, 0
- NOL available for carryforward: 0, 0, 0, 0
- Carryforward from this year utilized: 0, 0, 0
- Total NOL utilized: 0, 0, 0, 0, 0

NOL available for utilization in future years
- 2034: 0 (47,000), 0
- 2035: 0 (47,000)
- 2036: 0 (47,000)
- 2037: 0
- 2038: 0

Expiration details
- NOL expiration year: 2034, 2035, 2036, 2037, 2038
- Amount expiring: 0, 0, 0, 0

Less NOLs allowed – computed
- 0, 0, 0, 0, 0

Less NOLs allowed – scenario

Update all
Apportionment Strategy
Maximizing NOLs via Apportionment

- **In year NOL generated**
  - **Post-Apportionment** states
    - Make NOL larger through inter-company transactions, other state tax deductions, or state allocable income
    - Increase apportionment % **in year incurred**
  - **Pre-Apportionment** states - focus on utilization year

- **In NOL utilization years**
  - Increase apportionment % **in year used**
  - Increase tax base through inter-company transactions
  - Transfer / sell assets to entity with NOL that create income
  - Convert C corporation to single-member LLC to apply losses against income of other entity
### Mixed Industry Groups

<table>
<thead>
<tr>
<th>Entity/Group</th>
<th>Motor Carriers</th>
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<td>Period begin</td>
<td>1/1/2014</td>
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<tr>
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<td>Scenario</td>
<td>VA Consol current group</td>
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#### Furniture 2014 - DT

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<table>
<thead>
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<th>FTI to use in this state</th>
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<tr>
<td>FTI as adjusted</td>
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<td>State deductions total</td>
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<tr>
<td>FTI adjusted to state net income/(loss)</td>
<td>(597,530,279)</td>
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<tr>
<td>Income/(loss) for pre-apportionment NOL</td>
<td>16,889,721</td>
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<tr>
<td>Less pre-apportionment NOL</td>
<td>0</td>
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<tr>
<td>FTI adjusted to state basis</td>
<td>(597,530,279)</td>
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<tr>
<td>Less state allocated income total</td>
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<tr>
<td>State income subject to apportionment</td>
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<tr>
<td>Apportionment factors:</td>
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<tr>
<td>Weighted sales factor</td>
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<tr>
<td>Weighted property factor</td>
<td>0.0000 %</td>
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<tr>
<td>Weighted payroll factor</td>
<td>0.0000 %</td>
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<tr>
<td>Total</td>
<td>2667888</td>
</tr>
</tbody>
</table>

---

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Post Apportionment Separate TN

- Filing separately in TN
- Wayne has large loss and a 5% TN apportionment
- Stark has large income and a 95% TN apportionment

Total Tax Liability: $7,129,457
Post Apportionment – Disregarded

Wayne
(C corp)

Stark
(LLC)

Now files 1 TN Return

Total Tax Liability: $4,201,926

Tax Savings: $2,927,531

Stark gets benefit of:
• Current Wayne loss
• Wayne NOL carryovers
• Apportionment reduced from 95% to 65%
Wayne and Stark combined TN NOL tracker shows NOL generation and utilization.
Sharing NOL carryover problem

**PROBLEM:** How do we increase the opportunity to share NOL carryovers between members of a combined return?

**SOLUTIONS:**
- **During year of loss** - If you know an entity will have losses and is not filing combined, consider the potential for filing combined in the year loss is generated (since current losses are generally sharable)
  - May be able to use argument similar to New Mexico case
  - If not, consider converting C corp to SMLLC
New Mexico Covenant Case

• *In the Matter of the Protest of Covenant Transportation Group Inc., N.M. Tax’n & Rev. Dep’t, No. 14-45* (Dec. 29, 2014)
  • Parent and 3 subsidiaries
  • 2 subsidiaries had NOLs
  • All 3 subsidiaries filed separate New Mexico returns
  • Federal law (IRC 172(a)) allows consolidated groups to deduct member NOLs arising in separate years
  • **NM regulation incorporates federal law and allows NOL deductions after change of reporting method**
  • Hearing officer held that nothing in NM law alters federal rules
  • *Covenant* could file combined return and utilize sub NOLs against income of other members of combined return
NM Separate Reporting Example

- Each files separately in NM
- Wayne **large loss** & 3% NM apportionment with NOL c/o
- Stark **large income** & 90% NM apportionment (no NOLs)
- Oscorp **large loss** & 15% NM apportionment with NOL c/o
- **Total New Mexico tax liability:** $6,436,189

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**NM Combined Reporting Example**

- Combined filing
- Total tax liability: $399,549
- Tax savings: $6,036,640
Different Carryback/over Periods
Since most states disallow carrybacks or have short carryback periods, utilization in the future is vital
- 29 states do not allow NOL carrybacks

Use some of the techniques we have described to improve utilization, such as:
- Apportionment factor adjustments
- State additions and subtractions
- Intercompany transactions
- Entity conversions
Special States
PA NOL cap controversy


- **Is PA NOL cap unconstitutional?**
  - Current cap is larger of $5 million or 30% of taxable income
    - During the year in the case (2007), the cap was $3 million or 12.5% of taxable income
  - Court unanimously ruled Nov. 2015 cap as unconstitutional
  - PA appealed
  - Oral arguments heard in PA Supreme Court 4/5/17
PA NOL cap controversy

- **Potential remedies**
  - Remove limitation entirely
  - Remove flat dollar cap and keep % cap
  - Remove 20 year carryover limit

- If flat dollar cap is removed and % cap kept, Nextel will receive no refund
  - Nextel could win case and get nothing

- Others could benefit from Nextel case
  - In 2007: 19,537 companies in PA had NOL carryovers; 19,303 had income of less than $3 million and were able to reduce their taxable income to zero
  - Only 1.2% or just 234 companies had income of more than $3 million
  - Nextel had income of $45 million with NOL carryovers of $150 million; NOL deduction was limited to $5.6 million
Montana NOL disallowance

- Montana disallows NOL deduction for any pre-merger Montana NOLs of merged corporations (MT. Code Ann. Sec. 15-31-119(8))

- *GBN, Inc. vs Montana* (1991)
  - Surviving corporation could not deduct NOLs of each merged corporation sustained prior to merger
  - Pre-merger loses by *surviving and target* corporations both disallowed

- A simple (F reorganization) is tax free for federal tax purposes and tax attributes carryover
  - Tax attributes of Montana NOLs *don’t carryover according to Montana*

- MT. Admin. Reg. 42.23.804(3) disallows pre-conversion NOLs of a corporation that has converted to a disregarded entity
MT Cautionary Tale…

If an empty shell corporation (NewCo) is created in a new state and CurrentCo is merged into NewCo, Montana NOL carryovers will not transfer to NewCo.

If 2 corporations merge, the pre-merger NOLs of both the surviving and target are not allowed to be carried to the surviving entity.
Louisiana NOL Complexity Abounds

- For tax returns filed on or after 7/1/15, the LA NOL deduction is limited as follows:
  - **First**, by 72% of the LA NOL carryforward
  - **Then**, by 72% of LA net income

- Simple example:
  - 2018 NOL carryforward = $1 million
    - 72% = 720,000
  - LA net income in 2019 = $3 million
    - 72% = $2,160,000
  - 2019 NOL utilization is limited to $720,000

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
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<tbody>
<tr>
<td>Post</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>N/A</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>(1,000,000)</td>
<td>3,000,000</td>
</tr>
<tr>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>(2,280,000)</td>
<td>(1,000,000)</td>
</tr>
<tr>
<td></td>
<td>720,000</td>
<td></td>
</tr>
</tbody>
</table>
Louisiana NOL complexity

- **The order of LA NOL carryover utilization**
  - Tax years before January 1, 2017 use **FIFO** method
  - Tax years after January 1, 2017 use **LIFO** method

- **Example:**
  - LA NOL carryover schedule is as follows:
    - 2014 – (500,000)
    - 2015 – (700,000)
    - 2016 – (900,000)
  - If the 2017 tax return shows LA net income of $400,000, the 2016 NOL would be used first

- Under the LIFO method, prior year NOLs have a **higher probability of expiring** before being utilized
Louisiana NOL complexity

- For tax years filed on or after 7/1/2015
  - LA NOL *carryback* period changed from 3 years to zero
  - LA NOL *carryforward* period changed from 15 to 20 years

- Disallowing carryback eliminates the opportunity to obtain immediate benefits from Louisiana NOLs

- Louisiana may have extended the carryforward period, but the other rules we discussed make it more difficult to utilize NOLs before they expire
Limit to lesser of 72% of Loss c/f or 72% of LA Net Income

FIFO Carryforward to 2016

1/1/2017 starts LIFO Carryforward
Acquisitions/Reorg Challenges
Proactive State Tax Planning is Key

Prior to the implementation of any acquisition/reorganization
• Determine whether state NOL carryovers can be used subsequent to that acquisition/reorganization
• Know 382/SRLY impacts
• ASC 805 & ASC 740 requires M&A impact during a quarter be included in quarterly financial statements
• Model out impacts to group filings & know carryover values
  • Adjust Valuation Allowance accordingly
State IRC Sec. 382 Limitations

- Internal Revenue Code (IRC) Sec. 382 limits the use of NOL carryforwards and certain built-in losses following an ownership change

- **The ‘good’ news:**
  - 35 states conform to IRC Sec. 382

- **The ‘bad’ news:**
  - Most states do not provide ‘explicit’ guidance on how to apply IRC Sec. 382
State IRC Sec. 382 Limitations

• Main questions:
  • Is the federal IRC Sec. 382 limitation apportioned?
    • 7 states explicitly say ‘yes’
    • 24 states provide no guidance

• If yes, what apportionment % is used? In year of ownership change or when utilized?
  • 26 states provide no guidance

• Is the IRC Sec. 382 limitation calculated on an entity or group basis within a state combined return?
  • 27 states provide no guidance
Corporations that acquire a loss corporation are generally required to limit the allowed Louisiana NOL carryover from an acquired corporation using one of the following three methods - the NOL that the acquiring corporation is allowed to deduct each year is limited to:

1. \[(\text{value of the loss corporation} \times \text{LA apportionment ratio}) \times \text{long-term tax-exempt rate}\];

2. \[(\text{value of the loss corporation} \times (\text{LA income} / \text{federal income from all sources on a LA basis})) \times \text{long-term tax-exempt rate}, \text{ OR}\]

3. \[(\text{LA NOL available from the acquired corporation for the year} \times (\text{NOL from the acquired corporation allowed for federal purposes} / \text{federal NOL available from the acquired corporation for the year})\]

**Louisiana Admin. Rev. Ruling No. 06-008 (May 31, 2006)**
State IRC Sec. 382 Limitations – South Carolina

- South Carolina follows IRC Sec. 382

- SC IRC Sec. 382 limitation depends on whether the loss corporation is 100% based in South Carolina or operates in multiple states, during the taxable year that the ownership change occurs

- If 100% based in South Carolina during the taxable year that the ownership change occurs,
  - SC IRC Sec. 382 limitation = federal IRC. Sec. 382 limitation

- If operating in multiple states during the taxable year that the ownership change occurs
  - SC IRC Sec. 382 limitation = the federal IRC Sec. 382 limitation x SC apportionment factor for the taxable year that the ownership change occurs
For example, assume the following for Company A at the time of ownership change:

- Company A’s value is $5,000,000;
- The applicable federal long-term tax exempt rate is 2.80%;
- Company A’s federal NOL carryforward is $1,000,000;
- Company A’s previously apportioned South Carolina NOL carryforward is $350,000;
- Company A’s South Carolina apportionment ratio for the year of the ownership change is 25%

The South Carolina IRC Sec. 382 limitation is $35,000 ($5,000,000 x 2.8% x 25%).

The taxpayer can use its pre-ownership change South Carolina NOL carryforward to offset up to $35,000 of its South Carolina taxable income in each year following the ownership change.
State IRC Sec. 382 Limitations – South Carolina

• Any pre-ownership change SC NOL carryforward that cannot be deducted in the tax year because of the SC IRC Sec. 382 limitation is carried forward to the following year

• SC NOL remains subject to the maximum 20 year carryforward period
• South Carolina example

• Track pre-change losses separately (before 2016)
State IRC Sec. 382 Limitations - EXAMPLE

- South Carolina example
- Separate schedule for 382 limited NOL
### State IRC Sec. 382 Limitations - EXAMPLE

#### South Carolina example

#### Adjustment for 382 utilization on regular NOL schedule

<table>
<thead>
<tr>
<th>NOL rules</th>
<th>Scenario details</th>
<th>State income/(loss) for NOL</th>
<th>NOL adjustments/limitations</th>
<th>State income/(loss) after adjustments</th>
<th>NOL utilization schedule</th>
<th>NOL utilization</th>
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</thead>
<tbody>
<tr>
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<td>0</td>
<td>2015</td>
<td>Less NOLs allowed – computed</td>
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<td>OsCorp - SC-Regular NOL (Entity)</td>
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<td>(7,000,000)</td>
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</tr>
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</table>

Additional notes on adjustment for 382 utilization on regular NOL schedule.
State Impacts of Federal Tax Reform
History

DEC 3, 1986
- **Introduced**
  - This is the first step in the legislative process.

DEC 3, 1986
- **Ordered Reported by Committee**
  - A committee has voted to issue a report to the full chamber recommending that the bill be considered further. Only about 1 in 4 bills are reported out of committee.

DEC 17, 1986
- **Passed House**
  - The bill was passed in a vote in the House. It goes to the Senate next. The vote was by Voice Vote so no record of individual votes was made.

JUN 24, 1986
- **Passed Senate with Changes**
  - The Senate passed the bill with changes not in the House version and sent it back to the House to approve the changes.

SEP 27, 1986
- **Conference Report Agreed to by Senate**
  - A conference committee was formed, comprising members of both the House and Senate, to resolve the differences in how each chamber passed the bill. The Senate approved the committee's report proposing the final form of the bill for consideration in both chambers. The House must also approve the conference report.

OCT 22, 1986
- **Enacted — Signed by the President**
  - The President signed the bill and it became law.

OCT 22, 1986
- **Text Published**
  - Updated bill text was published as of Passed Congress/Enrolled Bill.

[Read Text »](#)
History Shows States Decouple

Does Your State's Corporate Income Tax Code Conform With the Federal Tax Code?

https://taxfoundation.org/federal-tax-reform-the-impact-on-states/
Federal Tax Reform for NOLs

- Proposed Federal tax changes:
  - Full expensing of Fixed Assets (if enacted) drives up NOLs!
    - Offset by Border Tax or other non-allowable deductions or increases to taxable income?
  - NOL carryforward indefinitely - No carryback
  - Unused NOL carryforward has interest factor adjustment to compensate for inflation
  - In year of utilization
    - NOL C/F utilization limited to 90% of taxable income
  - IRC 382
    - No mention yet...
Federal Tax Reform

• Will states conform to NOL carryforward indefinitely?
  • 26 states carryforward 15 to 20 years; some 5 to 12 years
  • Other states follow federal currently

• Will states conform to no carryback?
  • Currently 29 states have no carryback

• Will states conform to interest factor adjustment and to 90% offset limitation?
  • In non-conforming pre-apportioned NOL states
    • States would have different NOL carryforward schedules and no longer simply be using the federal NOL
  • In post-apportioned NOL states
    • Already tracking a different NOL amount
Key Take Aways
Key Take Aways

• According to an analysis performed by Bloomberg BNA of the financial statements of the Fortune 1000, an estimated $200 billion in NOLs is sitting on their books.

• State NOL tracking is essential to tax compliance, provision and financial statement compliance.

• Managing and maximizing the cash / tax benefits related to the generation and utilization of state NOLs is complex. Strategies are available, but must be modeled.

• Tax departments are currently focused on leveraging technology to move away from spreadsheets to create tax ready data, better manage cash tax, reduce effective tax rate, and increase earnings per share.
  • Technology exists to do the same for State NOLs.
Q&A

Any Questions?
Thank You!

To learn more about managing state NOLs & state tax analysis in general, contact our speaker:

Diane Tinney at 703.341.3635 or dtinney@bna.com

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