TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Office of Inspections and Evaluations

The Internal Revenue Service Administered Corporate Net Operating Losses Efficiently and Effectively; However, Financial Reporting Could Be Improved

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

October 13, 2015

MEMORANDUM FOR DEPUTY COMMISSIONER FOR OPERATIONS SUPPORT
DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT

FROM: Gregory D. Kutz
Acting Deputy Inspector General for Inspections and Evaluations

SUBJECT: Final Evaluation Report – The Internal Revenue Service Administered Corporate Net Operating Losses Efficiently and Effectively; However, Financial Reporting Could Be Improved (# IE-13-015)

This report presents the results of our evaluation of Internal Revenue Service (IRS) plans, activities, and programs to administrate the tax laws for corporate net operating losses (NOL) and NOL carryovers. This evaluation was performed because of the increasing percentage of corporation returns filed reporting NOLs and the potential impact of those NOLs as carryforwards on future Federal corporation tax revenues. This evaluation was included in our Treasury Inspector General for Tax Administration Office of Inspections and Evaluations Fiscal Year 2015 Program Plan. This review addresses the major management challenge of Tax Compliance Initiatives.

Synopsis

Corporate NOLs occur when a C corporation's[1] allowable tax deductions exceed its gross income for the year. The Great Recession[2] caused corporate income tax receipts to drop from a

[1] When a business incorporates, it is a C corporation for tax purposes. The IRS treats the C corporation as a separate entity from its owners for income tax purposes.
[2] The Great Recession was the longest post World War II economic downturn lasting from December 2007 to June 2009 corresponding to Tax and Fiscal Years 2008 and 2009 and tax returns filed in Processing Years 2009 and 2010.

historic high of $395.5 billion in Fiscal Year (FY)[3] 2007 to a low of $225.5 billion in FY 2009. The corporate income tax returns filed during this period showed more than $722 billion in NOLs. Going forward, in Processing Year (PY)[4] 2012, corporate income tax returns showed that there were more than $1.96 trillion in NOL carryforwards available to be offset against future income tax.

The IRS has two significant responsibilities in administrating NOLs in accordance with established tax policies. First, the IRS receives the claims for NOL carrybacks and must expedite their processing to ensure that refunds are timely issued to avoid paying unnecessary interest. Second, the IRS has processes and procedures to determine the validity of loss claims and to ensure that NOL carryforwards are taken in accordance with legal guidelines.

Between PY 2007 and PY 2010, the number of carryback claims increased from 54,618 to 114,233 before declining to 44,308 in PY 2012.[5] Respectively, the amount of corporate carryback claims increased from nearly $7.8 billion to $68.5 billion before declining to $10 billion. The interest paid on corporate carrybacks rose from $10 million to a peak of $47 million in PY 2009 before declining to $4.4 million in PY 2012. It should be noted that the interest paid was reduced by 50 percent between PY 2009 and PY 2010. Therefore, the IRS became more efficient in reducing the percentage of interest paid during the period of increasing carryback return volumes.

In tax administration, the examination of income tax returns is an important tool to encourage voluntary compliance. Several factors were considered in determining the effectiveness of the examination program to mitigate the risks of potentially aggressive NOL positions. First, from a revenue perspective, an analysis of examination data showed that tax return examinations in which an NOL is present yields significantly less revenue than non-NOL returns. For example, in FY 2013, corporate return examinations in which an NOL was not present yielded nearly $691,833 per return in recommended assessments compared to only $128,802 per return when an NOL was present.

Second, in the four-year period (FYs 2010 to 2013) reviewed, the overall corporate examination coverage rate hovered around 1.5 percent. During this same period, examination coverage rates of corporate NOLs moved from a low of 0.55 percent in FY 2010 to 0.83 percent in FY 2013. Despite this increase, the NOL coverage rate is still significantly less than the non-NOL coverage rate of more than 1.9 percent. Consequently, an NOL return was considerably less likely to be selected for examination than a non-NOL return. However, from a risk mitigation

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[3] A fiscal year is any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
[4] The calendar year in which the tax return or document is processed by the IRS.
[5] Readers should keep in mind that returns processed in one year are returns reporting transactions for the prior tax year. For example, returns processed in PY 2010 were primarily Tax Year 2009 returns reporting transactions that took place in 2009 at the height of the Great Recession.

viewpoint, in PY 2010, 326 Coordinated Industry Case (CIC) program[6] NOL corporate returns were filed, accounting for $354 billion (49.07 percent) of the $722 billion in corporate NOLs filed. Subsequently, in FY 2011, the IRS's CIC program examined 77 known NOL returns of these 326 corporate NOL returns for an examination coverage rate[7] of about 23.6 percent. The 77 CIC corporation NOL returns examined represented only 1.58 percent of known corporation NOL returns examined, but accounted for $423 million (62.4 percent) out of the $678 million of the recommended assessments. Therefore, the IRS examined a substantial portion of the NOL dollar amounts.

Finally to mitigate compliance risks, the U.S. tax system contains several disclosure and anti-abuse provisions to deter aggressive NOL transactions. The disclosures are required from the largest corporations with the most substantial NOL dollar losses. In addition, these corporations are under constant scrutiny and are subject to examination. The very largest corporations are examined on a constant basis.

In an ancillary issue, the IRS could provide additional disclosure to Federal financial statements by adding a note regarding the corporate NOL carryforward amounts' effect on Government tax revenues. Our estimate is that the $1.96 trillion in carryforwards reported in PY 2012 have a net present value that ranges from about $371 billion to $414 billion[8] in tax. However, this information is not readily available in Government information sources and is material to future tax revenues.

Recommendation

The Treasury Inspector General for Tax Administration recommended that the Chief Financial Officer should include a note in other accompanying unaudited information to the IRS financial statements listing the amount, net present value, and description of the corporate NOL carryforward amounts' impact on future tax revenues.

Response

The IRS disagreed with our recommendation citing the disclosure is not required by existing Federal accounting standards; it is unclear the value of reporting the impact of the NOL carryforward as a separate element affecting revenue collections in the financial statements; and

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[6] The CIC program is the IRS examination program that continually examines the largest corporations using a team approach. The number of taxpayers participating in the program ranged from 989 to 788 from 2008 to 2013, respectively.
[7] The examination coverage rate is derived by dividing the number of returns examined by the total number of tax returns filed in the previous year.
[8] See Appendix IV.

the benefits of deriving a meaningful calculation would be outweighed by the burden of doing so. Management's response to the draft report is included as Appendix XVI.

Office of Inspections and Evaluations Comment: The Treasury Inspector General for Tax Administration agrees that NOL disclosures are not required; however, we continue to believe that due to the material impact of NOL carryforwards on future corporate tax revenue, disclosure is warranted. The Treasury Inspector General for Tax Administration concurs with the IRS that any calculation of the effect of corporate NOL carryforwards will be based on estimates and assumptions. Similarly, the IRS Tax Gap[9] estimate presented in the financial statements also employs estimates and assumptions. Therefore, we are uncertain why there would be a reluctance to use estimates and assumptions in one circumstance and not in another where the amount is also material to future revenue. In addition, although the Government Accountability Office performs certain limited procedures such as making inquiries to management, it does not express an opinion or provide any assurances on the Tax Gap information and would not be required to do so for any NOL carryover estimates.

If you have any questions, please contact me or Phil Shropshire, Director, Special Tax Matters.

[9] The Tax Gap is the estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.

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Abbreviations

AIMS	Audit Information Management System
AMT	Alternative Minimum Tax
AMTI	Alternative Minimum Taxable Income
ATNOLD	Alternative Tax Net Operating Loss Deduction
BMF	Business Master File
BRTF	Business Return Transaction File
C/F	Carryforward
CIC	Coordinated Industry Case
EOI	Exchange of Information
FY	Fiscal Year
GAO	Government Accountability Office
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
JITSIC	Joint International Tax Shelter Information Centre
LB&I	Large Business and International
NOL	Net Operating Loss
NOLD	Net Operating Loss Deduction
OECD	Organisation for Economic Cooperation and Development
OTSA	Office of Tax Shelter Analysis
PVIF	Present Value Interest Factor
PVIFA	Present Value Interest Factor of an Annuity
PY	Processing Year
SB/SE	Small Business/Self-Employed
SFFAS	Statement of Federal Financial Accounting Standards
TIGTA	Treasury Inspector General for Tax Administration

Background

A corporate net operating loss (NOL) occurs when a C corporation's's[1] allowable tax deductions exceed its gross income for the year. When a refund of previously paid taxes is available, a corporation is generally allowed under the Internal Revenue Code (I.R.C.) to carryback an NOL two years prior to the year the NOL is generated. The carryback results in a refund of income taxes previously paid. If the NOL is not exhausted by the carryback, the remaining NOL can be carried forward for up to 20 years. A corporation can make an election to waive the carryback period and use only the 20-year carryforward period.[2]

The purpose of the NOL provisions is "…to ameliorate the unduly drastic consequences of taxing income strictly on an annual basis. They were designed to permit a taxpayer to set off its lean years against its lush years, and to strike something like an average taxable income computed over a period longer than one year."

The underlying objective of permitting a NOL carryover[3] is to allow a business to calculate taxable profit by averaging its income - including negative income - over several years. The purpose of the NOL provisions are summarized from the case *Lisbon Shops, Inc. v. Koehler*, 353 U.S. 382, 386 (1957).

> *…to ameliorate the unduly drastic consequences of taxing income strictly on an annual basis. They were designed to permit a taxpayer to set off its lean years against its lush years, and to strike something like an average taxable income computed over a period longer than one year.*[4]

Income averaging recognizes that start-up businesses often incur years of losses before profitability and that many established businesses experience temporary losses in the course of an economic downturn.

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[1] When a business incorporates, it is a C corporation for tax purposes. The Internal Revenue Code treats the C corporation as a separate entity from its owners for income tax purposes.
[2] For a corporation to waive the carryback period, it must select the box on Schedule K, *Other Information*, Form 1120, *U.S. Corporation Income Tax Return*. Consolidated tax return filers making the election must also attach a statement to the original return, filed by the due date (including extensions) for the NOL year.
[3] If an NOL is more than the taxable income for the year to which it is carried (figured before deducting the NOL), there may be an NOL carryover. Certain modifications to taxable income may be made to determine how much NOL will be used up in that year and how much can be carried over to the next tax year. The carryover is the excess of the NOL deduction over the modified taxable income for the carryback or carryforward year.
[4] Graetz, Michael J. and Deborah H. Schenk, *Federal Income Taxation, Principles and Policies*, Fourth Edition, Foundation Press, 2002 (pg. 679).

For a historical viewpoint, the NOL provision was first enacted at the close of World War I in the Revenue Act of 1918.[5] The provision anticipated that businesses would have losses as the war work ended and factories retooled for the return to a peacetime economy. The act temporarily allowed for an NOL to be carried back one year and then forward one year. Over the decades there have been several changes, including omitting the provision entirely in the National Industrial Recovery Act of 1933[6] during the Great Depression. The NOL provision was reenacted in 1939 as a two-year carryforward in the I.R.C. of 1939 and a two-year carryback was added to the provision in 1942. Further changes were made in the 1950s to extend the carryback to three years. The carryover period was changed to five years in 1962. Then in the 1970s, the carryover was again extended, this time to seven years. The Economic Recovery Tax Act of 1981[7] further increased the carryover period to 15 years. In the Taxpayer Relief Act of 1997,[8] the carryback was reduced to two years and the carryover period was increased to 20 years. Various subsequent changes have been made to I.R.C. Section (§) 172, the NOL deduction rules, including the types of losses covered and the carryover periods.

As designed, the NOL provisions provide two primary benefits. First, the NOL provision, specifically the NOL carryback, allows businesses to make higher risk investments than otherwise possible because the majority of the tax burden falls on higher risk investments.[9] In essence, the Government acts as a partner with taxpayers when losses are allowed to be carried back, sharing both the return of investment (tax revenue) and the risk of investment (revenue loss). Because the Government can spread risk better than the private markets, NOL provisions may encourage higher risk activities that can increase technological innovation and economic efficiency.

Second, the NOL carryback provision may also provide a modest amount of economic stimulus during a period of economic downturn.[10] Businesses experiencing large current losses can carry their losses back two years for a refund of taxes previously paid. In the two most recent economic downturns, Congress temporarily extended the NOL carryback provision. For instance, taxpayers were allowed to carryback Tax Years 2008 and 2009 NOLs for up to five years. This extension enabled some businesses to recover more of their previously paid taxes.

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[5] Pub. L. No. 65-254, Section 204 or 40 Stat. 1060. See also Federal Revenue Act of 1918, Complete Text with Reference Notes, Tables and Index, National Bank of Commerce in New York, p. 12-13 (Feb. 1919).
[6] Pub. L. No. 73-67, 48 Stat. 195.
[7] Pub. L. No. 97-34, Section 207(a)(1), 95 Stat. 172.
[8] Pub. L. No. 105-34 Section 1082(a), 111 Stat. 788.
[9] Domar, Evsey D. and Richard A. Musgrave, *Proportional Income Taxation and Risk-Taking*, The Quarterly Journal of Economics, Vol. 58 (May 1944).
[10] The Congressional Budget Office has attempted to quantify the stimulative effect on the Nation's gross domestic product of extending the NOL carryback period. The Congressional Budget Office estimates that every $1.00 in NOL carrybacks translates into a gross domestic product increase of between $0 and $0.40. In contrast, the Congressional Budget Office estimates that every $1.00 increase in Federal Government purchases increases gross domestic product by between $1.00 and $2.50, while a well-targeted temporary $1.00 reduction in individual taxes increases gross domestic product by between $0.50 and $1.70.

The refund could provide businesses that are unable to raise sufficient capital in the financial markets with an additional financing source in order to continue operations.

To discourage the abuse of NOL provisions, there are several administrative and tax policy backstops. These include administrative disclosure requirements; designation of abusive, loss-generating transactions as reportable transactions; statutory and regulatory anti-abuse provisions; and the corporate Alternative Minimum Tax (AMT).

For perspective, the treatment of operating losses is not exclusive to the Federal income tax system of the United States. The tax codes of many industrialized countries and States within the United States also contain NOL provisions. The NOL provisions can provide significant challenges to a revenue system. For administration purposes, a loss carryback requires reopening a taxpayer's assessment or tax return for a prior tax period(s). Furthermore, for some governments, the NOL carryback can create revenue challenges because the refunds are paid from current year receipts. This is especially true during a general economic downturn when tax revenues decline and demand for NOL carryback refunds increases. Figure 1 provides an overview comparison of the NOL provisions from around the globe.

Figure 1: Country-by-Country Comparison of NOL Provisions

Country	Loss Carryback	Loss Carryforward	Restrictions
Australia	No	Indefinite	Change of ownership and activity
Austria	No	Indefinite	Change of ownership and activity
Canada	3 years	20 years	Change of ownership and activity
Denmark	No	Indefinite	Change of ownership and other criteria
France	3 years	Indefinite	Change of activity
Germany	1 year	Indefinite	Change of ownership
Ireland	1 year	Indefinite	Change of ownership and activity
Italy	No	5 years	Change of ownership and activity, mergers
Mexico	No	10 years	Change of ownership and activity, mergers
Netherlands	1 year	9 years	Change of ownership and activity
New Zealand	No	Indefinite	Change of ownership
Norway	No	Indefinite	Change of ownership
Spain	No	15 years	Change of ownership
Sweden	No	Indefinite	Change of ownership
Switzerland	No	7 years	Change of ownership and restart of activity
United Kingdom	1 year	Indefinite (against profits of the same trade)	Change of ownership and activity
United States	2 years	20 years	Change of ownership

Source: Organisation for Economic Cooperation and Development (OECD), Corporate Loss Utilization Through Aggressive Tax Planning, August 2011.

The Internal Revenue Service (IRS) has two significant responsibilities in administrating NOLs in accordance with established tax policies. First, the IRS receives the claims for NOL carrybacks and must expedite their processing to ensure that refunds are timely issued to avoid unnecessarily paying interest. Second, the IRS needs to determine the validity of loss claims to ensure that NOL carryforwards are used in accordance with legal guidelines.

This evaluation was performed at the IRS National Headquarters in Washington, D.C., in the Large Business and International (LB&I) Division, the Small Business/Self-Employed (SB/SE) Division, the Wage and Investment Division, and the Office of the Chief Financial Officer during the period of August 2013 to May 2014. We conducted this evaluation in accordance with the Council of the Inspectors General for Integrity and Efficiency Quality Standards for Inspections. Detailed information on our objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

The Great Recession[11] caused corporation income tax receipts to drop from a historic high of $395.5 billion in Fiscal Year (FY)[12] 2007 to a low of $225.5 billion in FY 2009. The corporate income tax returns filed for this period showed more than $722 billion in NOLs. Going forward, in Processing Year (PY)[13] 2012, corporate income tax returns showed more than $1.96 trillion in NOL carryforwards available to be offset against future income tax. From a tax administration perspective, the IRS is charged with timely processing carryback refunds to avoid unnecessary interest payments, and to ensure that corporate income tax returns with NOLs are compliant with applicable tax laws.

The IRS processed the high volume of carryback claims[14] with efficiency and effectiveness. For example, the number of carryback claims increased from 54,618 for nearly $7.8 billion in PY 2007 to more than 114,233 for $68.5 billion in PY 2010. A 109 percent increase in the number of claims and a nearly 778 percent increase in the amount of claims. The interest paid on corporate carrybacks rose from $10.2 million in PY 2007 to $34.9 million in PY 2010, a 243 percent increase. However, the interest as a percentage of carryback amounts fell more than 50 percent during this period from 0.13 percent ($10.2 million/$7.8 billion) in PY 2007 to 0.05 percent ($34.9 million/$68.5 billion). Therefore, the IRS became more efficient in reducing the percentage of interest paid during the period of increasing carryback return volumes.

To encourage voluntary compliance, the IRS requires the largest corporations[15] to include additional disclosures with their income tax returns regarding transactions that could create NOLs. These requirements, coupled with statutory anti-abuse provisions and continual examinations of the largest corporations, help mitigate the risks associated with identifying aggressive tax transactions that create losses.

In an ancillary issue, the IRS could provide additional disclosure to Federal financial statements by adding a note regarding the corporate NOL carryforward amounts' impact on Government tax revenues. Our estimate is that the $1.96 trillion in carryforwards reported in PY 2012 have a net

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[11] The Great Recession was the longest post World War II economic downturn lasting from December 2007 to June 2009 corresponding to Tax and Fiscal Years 2008 and 2009 and tax returns filed in Processing Years 2009 and 2010.

[12] A yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

[13] The calendar year in which the tax return or document is processed by the IRS.

[14] All sources of corporate carrybacks are included in our statistics because NOLs cannot be separately identified without examining the source documents. Carrybacks arise primarily from three sources: an NOL or a loss from operations of a life insurance company; net capital losses; and unused general business credit.

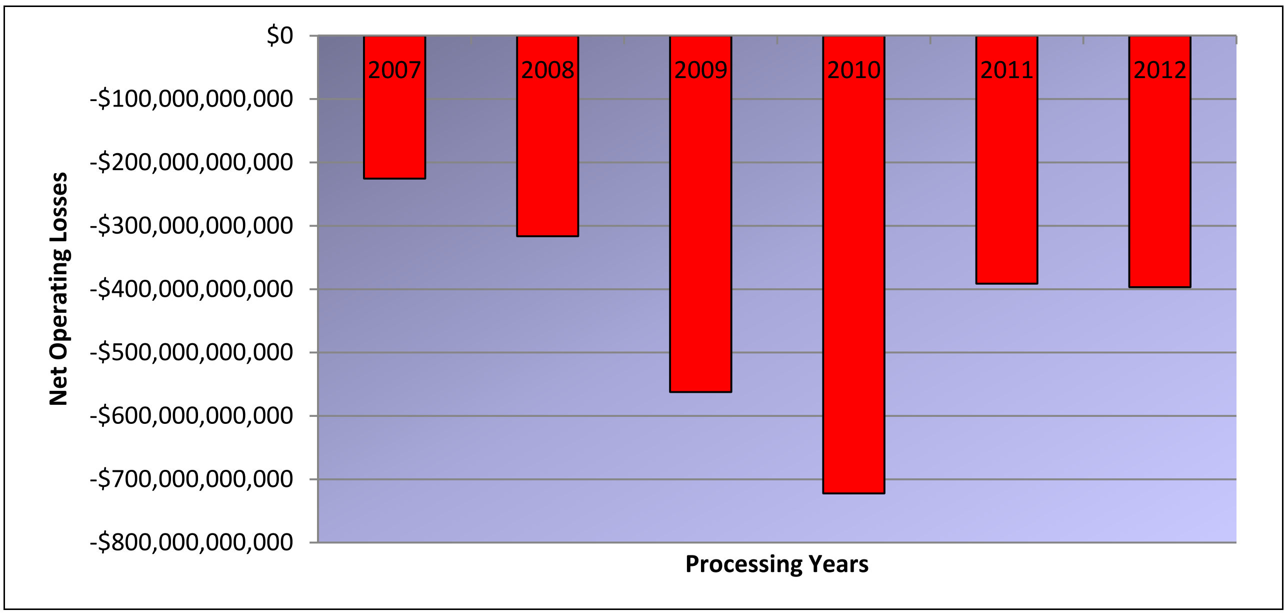
[15] Corporations with assets of $10 million or more.

present value that ranges from about $371 billion to $414 billion[16] in tax. However, this information is not readily available in Government information sources and is material to future tax revenues.

The Rate and Dollar Amount of Net Operating Losses Peaked in Processing Year 2010

The Great Recession officially began in December 2007. Corporate NOLs attributable to the Great Recession peaked at $722.4 billion on Forms 1120 filed in PY 2010 (see Figure 2). Of the 1,991,336 corporate returns filed in PY 2010, 45.3 percent reported an NOL.

Figure 2: Corporate NOLs Reported (PYs 2007 to 2012)



Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of the corporate Business Return Transaction File (BRTF)[17] for PYs 2007 to 2012.

To provide context, in PY 2007, 39.5 percent of 2,197,233 corporate returns[18] filed reported NOLs of $225.5 billion. In contrast with PY 2007, PY 2010 showed a 14.7 percent increase

[16] See Appendix IV.
[17] The BRTF is a computer file of the transcribed or transmitted line items on all business returns and their accompanying schedules or forms.
[18] Corporations filing Form 1120 have been in a long-term decline since the 1990s as businesses have moved to other forms of entities such S corporations, partnerships, limited liability companies, limited liability partnerships, and others. During the period of our study, PY 2007 to PY 2012 corporate filings declined from 2,197,233 to 1,909,303.

((45.3 percent – 39.5 percent)/39.5 percent) in the rate of returns reporting NOLs and a 220 percent increase (($722.4 billion – $225.5 billion)/$225.5 billion) in the amount of NOLs. Then two years later in PY 2012, the rate of returns with NOLs declined to 42.6 percent out of 1,909,305 corporate returns filed, while the amount of NOLs reported declined to $396.8 billion. Therefore, return volume fell by 6 percent ((42.6 percent – 45.3 percent)/45.3 percent), while the NOLs dollar amount fell by 45 percent (($396.8 billion - $722.4 billion)/$722.4 billion). It is noteworthy that after the Great Recession, the percentage of returns with NOLs and the overall amounts of NOLs remain at a higher level than prior to the Great Recession. These results have an effect on tax administration through increased use of the IRS's resources in processing applications for NOL carryback refunds and on compliance activities related to NOL returns.

The Internal Revenue Service Processed the Increase in Corporate Carryback Volume in Processing Year 2010 in an Efficient Manner

As previously stated, generally a corporation will carry an NOL back two years prior to the year the NOL is generated to receive a refund of previously paid taxes. A corporation can elect to waive the carryback period and use only the 20-year carryforward period. This can be beneficial when the corporation did not pay taxes in the carryback period or the taxes paid in the carryback period were previously refunded.[19]

A corporation carries the NOL back to the prior two years by filing Form 1139, *Corporation Application for Tentative Refund* (see Appendix VI), or Form 1120X, *Amended U.S. Corporation Income Tax Return* (see Appendix V). Generally, the corporation must file Form 1139 within 12 months of the end of the tax year[20] in which an NOL arose. The corporation must file its income tax return for the tax year containing the NOL no later than the date it files the Form 1139.

The IRS will process this application within 90 days of the later of:

- The date the corporation files the complete application, or
- The last day of the month that includes the due date (including extensions) for filing the corporation's income tax return for the year in which the loss or credit arose.

By law, an application for a tentative refund, Form 1139, is not treated as a claim for credit or refund.[21] It may be disallowed if there are any material omissions or math errors that are not corrected within the 90-day period. If the application is disallowed in whole or in part, no court

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[19] For a corporation to waive the carryback period, it must select the box on Schedule K, Form 1120. Consolidated tax return filers making the election must also attach a statement to the original return, filed by the due date (including extensions) for the NOL year.
[20] The 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due.
[21] I.R.C. § 6411(a) and Treas. Reg. § 1.6411-3(c).

suit challenging the disallowance may be filed. But the corporation can file a regular claim, Form 1120X, for credit or refund. Generally, the corporation must file an amended return within three years after the date the return was due for the tax year in which an NOL arose. Corporations must file Form 1120X instead of Form 1139 to carryback:

- A prior year foreign tax credit released due to an NOL, or
- A prior year general business credit released because of the release of the foreign tax credit.

It should be noted that the processing procedures for an amended return, Form 1120X, and Form 1139 are different. The IRS is not required to process an amended return within 90 days. However, if the IRS does not process it within six months from the date a corporation files the amended return, the corporation can file suit in court. If the IRS disallows a claim on an amended return and the corporation disagrees with that determination, the corporation must file suit no later than two years after the date the IRS disallows it.

Corporate NOL carrybacks received are processed by the Accounts Management unit.[22] Within the IRS, corporate NOL carrybacks filed on Form 1139 are referred to as tentative carryback refunds and those filed on Form 1120X are referred to as restricted interest claims. The tax year in which the loss occurred is the loss year, and the tax year the loss is applied, carryback, is the gain year. Joint Committee Cases must be expedited to the Examination function due to interest considerations, if the combined refund amount is $2 million or more.[23]

Generally, the IRS must pay interest if the carryback overpayment is not refunded within 45 days of the later of:

- The due date of the loss year return;
- The received date of the delinquent loss year return;
- The date the loss year return is filed in processible form;
- The application or claim received date; or
- The application or claim processible date.

[22] The Accounts Management unit is in the Wage and Investment Division. Internal Revenue Manual 21.5.9 Carrybacks – provides the detailed procedures for processing carrybacks. The Internal Revenue Manual is the IRS's primary official source of instructions to staff relating to the administration and operations of the IRS. It contains the directions employees need to carry out their operational responsibilities.

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Between PY 2007 and PY 2010, the number of carryback claims increased from 54,618 to 114,233 before declining to 44,308 in PY 2012 (see Figure 3).[24] Respectively, the amount of corporate carryback claims increased from nearly $7.8 billion to $68.4 billion before declining to $10 billion. The interest paid on corporate carrybacks rose from $10 million to a peak of $47 million in PY 2009 before declining to $4.4 million in PY 2012. It should be noted that the percentage of interest paid was reduced by 50 percent between PY 2009 and PY 2010. Therefore, the IRS became more efficient in reducing the percentage of interest paid during the period of increasing carryback return volumes.

Figure 3 shows the IRS-reported corporate carryback refunds[25] and the corresponding interest amounts paid in PY 2007 to 2012.

Figure 3: Corporate Carrybacks and Interest Due to Taxpayers (PYs 2007 to 2012)

PY	2007	2008	2009	2010	2011	2012
Corporate Carrybacks Processed						
Form 1139	43,619	47,631	86,959	99,859	55,564	34,528
Form 1120X	10,999	10,415	12,431	14,374	13,199	9,780
Total	54,618	58,046	99,390	114,233	68,763	44,308
Corporate Carryback Amounts Processed						
Form 1139	$7,142,709,387	$13,456,626,852	$47,382,785,795	$67,718,220,587	$15,090,210,360	$9,406,444,556
Form 1120X	656,900,690	767,667,989	509,745,885	747,703,709	670,066,489	613,565,614
Total	$7,799,610,077	$14,224,294,841	$47,892,531,680	$68,465,924,296	$15,760,276,849	$10,020,010,170
Interest Paid on Corporate Carrybacks						
Return Volume	7,742	10,814	29,360	37,629	18,285	8,386
Amount	$10,195,431	$9,992,948	$47,449,131	$34,945,922	$5,324,541	$4,417,934
Interest As Percentage of Carryback Amounts	0.13%	0.07%	0.10%	0.05%	0.03%	0.04%

Source: TIGTA analysis of the corporate Business Master File (BMF)[26] for PYs 2007 to 2012.

[24] Readers should keep in mind that returns processed in one year are returns reporting transactions for the prior tax year. For example, returns processed in PY 2010 were primarily Tax Year 2009 returns reporting transactions that took place in 2009 at the height of the Great Recession.
[25] While NOLs comprise a large portion of corporate carrybacks, it should be remembered that corporate carrybacks can also be composed of net capital losses and unused general business credits. The IRS Business Master File data used in Figure 3 to illustrate IRS carryback results do not differentiate between the transactions' sources.
[26] The BMF is the IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

The Internal Revenue Service Encountered Significant Increases in the Rate of Net Operating Loss Returns Received

In tax administration, the examination of income tax returns is an important tool to encourage voluntary compliance. The IRS corporate examination program is managed in two separate operating divisions. The SB/SE Division is responsible for corporations with assets $10 million and below, and the LB&I Division is responsible for all corporations with assets exceeding $10 million. The SB/SE Division examination program is responsible for approximately 98 percent[27] of corporate returns filed. On the other hand, the LB&I Division is responsible for the examination program for approximately 88 percent[28] of the NOL dollar losses filed in PY 2010.

To effectively administrate the NOL provisions, the IRS must identify the compliance risk presented by NOL returns and identify methods to mitigate those risks. The Great Recession created significantly more compliance risks because of the dramatic losses reported on corporate income tax returns. An analysis of the corporate return filing information gives insight into the changes in the NOL returns from PY 2007 through the Great Recession.

In PY 2007, prior to the effects of the Great Recession, all asset classes reported positive net income (see Figure 4). Total net income reported that year was about $1.1 trillion while NOLs totaled about $225 billion. Returns claiming an NOL were about 39.5 percent of the corporate return population, versus 60.5 percent that did not claim an NOL.

[27] Calculated from returns $10 million and below in assets equaling 2,149,197 divided by the total corporate return population of 2,197,233 for PY 2007.
[28] NOLs filed on returns more than $10 million in assets, $638.9 billion divided by the total corporate NOLs of $722.4 billion for PY 2010.

Figure 4: PY 2007 Income and NOLs Reported by Ending Assets

Ending Assets	Returns Filed	Net Income/ Loss Reported	Returns Filed With NOL	NOL Amount
Less Than $250,000	1,575,282	$20,120,708,017	660,368	$-19,134,177,845
$250,000 to < $1 Million	364,646	771,961,537	127,636	-11,836,569,734
$1 Million to < $5 Million	179,083	494,899,705	56,344	-21,578,106,741
$5 Million to < $10 Million	30,186	332,171,328	9,722	-11,963,110,612
SB/SE Division Subtotal	2,149,197	$21,719,740,587	854,070	$-64,511,964,932
$10 Million to < $50 Million	29,197	5,429,332,606	9,893	-31,013,296,519
$50 Million to < $100 Million	5,785	6,521,556,333	1,875	-13,394,839,820
$100 Million to < $250 Million	5,472	22,403,388,570	1,505	-15,388,873,516
$250 Million to < $500 Million	2,755	25,083,026,097	660	-13,627,250,962
$500 Million to < $1 Billion	1,887	41,099,649,623	422	-11,880,844,668
$1 Billion to < $5 Billion	2,044	160,935,970,669	426	-38,580,738,755
$5 Billion to < $20 Billion	612	213,395,430,232	97	-21,920,160,477
$20 Billion or More	284	597,722,357,899	27	-15,164,237,994
LB&I Division Subtotal	48,036	$1,072,590,712,029	14,905	$-160,970,242,711
Total	2,197,233	$1,094,310,452,616	868,975	$-225,482,207,643

Source: TIGTA analysis of the corporate BRTF for PY 2007.

By PY 2010, when the effect of the Great Recession was reported to the IRS on corporate income tax returns, significant changes had occurred. Specifically, only two asset classes of corporations showed positive net income that year (see Figure 5):

- $1 billion to less than $5 billion reported net income of $44 billion.
- $20 billion or more reported net income of $330 billion.

All the remaining asset classes showed losses. The net income reported for PY 2010 was $247 billion while the NOL amounts reported were nearly $722 billion. The volume of returns with NOLs reached 45 percent while returns without NOLs were 55 percent of the corporate population. Between PY 2007 and PY 2010, net income reported by corporations shrank 77 percent. Additionally, the NOL dollar percentage shifted between the SB/SE Division and the LB&I Division dramatically between PY 2007 and PY 2010. In PY 2007, SB/SE Division corporations accounted for about 29 percent of the $225 billion NOL dollars; whereas, in PY 2010, SB/SE Division corporations accounted for only about 11.6 percent of the $722 billion NOL dollars.

Figure 5: PY 2010 Income and NOLs Reported by Ending Assets

Ending Assets	Returns Filed	Net Income/ Loss Reported	Returns Filed With NOL	NOL Amount
Less Than $250,000	1,428,584	$-13,551,081,214	661,245	$-24,939,951,096
$250,000 to < $1 Million	327,537	-6,026,749,697	141,906	-14,943,278,837
$1 Million to < $5 Million	162,348	-13,441,439,576	67,028	-28,013,614,511
$5 Million to < $10 Million	27,215	-7,596,418,314	11,624	-15,627,484,830
SB/SE Division Subtotal	1,945,684	$-40,615,688,801	881,803	$-83,524,329,274
$10 Million to < $50 Million	26,862	-19,557,766,773	12,362	-43,421,141,127
$50 Million to < $100 Million	5,750	-10,339,720,793	2,698	-24,397,630,759
$100 Million to < $250 Million	5,365	-5,743,290,709	2,339	-30,450,358,686
$250 Million to < $500 Million	2,761	-6,882,851,804	1,166	-32,210,613,669
$500 Million to < $1 Billion	1,863	-430,631,436	756	-35,640,459,290
$1 Billion to < $5 Billion	2,069	44,353,287,494	799	-82,138,182,844
$5 Billion to < $20 Billion	656	-43,758,790,207	236	-206,666,915,943
$20 Billion or More	326	330,239,849,719	102	-183,950,912,601
LB&I Division Subtotal	45,652	$287,880,085,491	20,458	$-638,876,214,919
Total	1,991,336	$247,264,396,690	902,261	$-722,400,544,193

Source: TIGTA analysis of the corporate BRTF for PY 2010.

In PY 2012, with the Great Recession over, corporate net income still had not recovered to its pre-recession levels. Net income reported was still negative in the five lowest asset classes from less than $250,000 to $50 million in corporate assets (see Figure 6). Overall, net income in PY 2012 was nearly $675 billion, an increase from a low of $247 billion in PY 2010, but still considerably below the pre-recession level of $1.1 trillion reported in PY 2007. NOLs declined to about $397 billion from $722 billion in PY 2010, but still exceeded the pre-recession level of $225 billion in PY 2007. The percentage of corporate income tax returns with NOLs declined to 42.6 percent in PY 2012 from 45.3 percent in PY 2010, but again was still above the pre-recession level of 39.5 percent.

Figure 6: PY 2012 Income and NOLs Reported by Asset Class

Ending Assets	Returns Filed	Net Income/ Loss Reported	Returns Filed With NOL	NOL Amount
Less Than $250,000	1,369,047	$-9,739,260,673	604,358	$-23,473,763,535
$250,000 to < $1 Million	308,706	-2,844,381,348	122,436	-12,360,020,285
$1 Million to < $5 Million	157,059	-6,551,506,342	57,781	-22,270,001,533
$5 Million to < $10 Million	27,041	-4,978,619,538	10,293	-13,904,376,853
SB/SE Division Subtotal	1,861,853	$-24,113,767,901	794,868	$-72,008,162,206
$10 Million to < $50 Million	27,714	-7,429,121,723	11,447	-34,560,067,158
$50 Million to < $100 Million	5,978	162,242,295	2,566	-16,865,836,497
$100 Million to < $250 Million	5,687	5,572,326,212	2,214	-23,122,992,076
$250 Million to < $500 Million	2,947	6,684,306,965	1,119	-23,390,711,468
$500 Million to < $1 Billion	1,948	17,159,781,531	707	-22,396,997,379
$1Billion to < $5 Billion	2,161	83,793,932,701	704	-56,880,578,944
$5 Billion to < $20 Billion	700	138,689,649,310	218	-65,462,543,601
$20 Billion or More	317	454,446,357,314	67	-82,104,937,544
LB&I Division Subtotal	47,452	$699,079,474,605	19,042	$-324,784,664,667
Total	1,909,305	$674,965,706,704	813,910	$-396,792,826,873

Source: TIGTA analysis of the corporate BRTF for PY 2012.

Several risk management strategies need to be analyzed to determine whether the IRS effectively mitigated the compliance risks associated with NOL returns. First, one measure of the IRS's overall examination program is the "examination coverage rate," which is calculated by dividing the number of returns examined by the total number of tax returns filed in the previous year. Accordingly, the corporate examination coverage rate is determined by dividing the number of corporate returns examined by the total number of corporate tax returns filed in the previous year. (It follows that the examination coverage rate of returns with and without corporate NOLs is calculated in the same manner.)

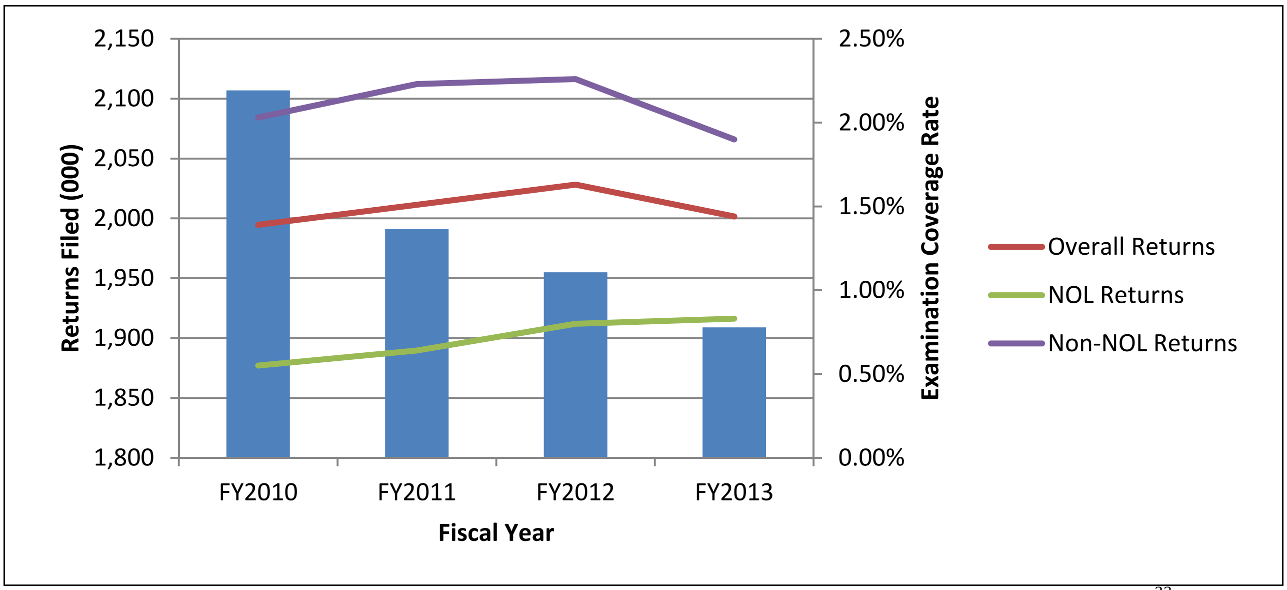
For clarity, the IRS has no special policy pertaining to the selection of NOL returns for examination. NOL returns are selected under the same general examination policy as all other returns. The IRS policy statement on the selection of returns for examination describes both the purpose of tax return examinations and the concept of coverage:

> *The primary objective in selecting returns for examination is to promote the highest degree of voluntary compliance on the part of taxpayers. This requires the exercise of professional judgment in selecting sufficient returns of all classes of returns in order to assure all taxpayers of equitable consideration, in utilizing*

> *available experience and statistics indicating the probability of substantial error, and in making the most efficient use of examination staffing and other resources.*[29]

In the four-year period (FYs 2010 to 2013) reviewed, the overall corporate examination coverage rate hovered around 1.5 percent (see Figure 7).[30] More specifically, examination coverage rates of corporate NOLs moved from a low of 0.55 percent in FY 2010 to 0.83 percent in FY 2013. Despite this increase, the NOL coverage rate is still significantly less than the non-NOL coverage rate of more than 1.9 percent.[31] Consequently, an NOL return was considerably less likely to be selected for examination than a non-NOL return.

Figure 7: Corporation Income Tax Examination Coverage (FYs 2010 –2013)



Source: TIGTA estimate based on computer analysis of the Audit Information Management System (AIMS)[32] *for FYs 2010 to 2013 and the BRTF for PYs 2009 to 2012.*

A more detailed approach is to analyze the coverage data by asset level for a single fiscal year. In FY 2011, the overall coverage rate, NOL coverage rate, and non-NOL coverage rate, all increased as the asset level of the corporate tax returns also increased (see Figure 8). These same patterns were present for other years (FYs 2010 to 2012) in our analysis. The NOL coverage rate starts at a low of 0.33 percent for corporate returns with assets less than $250,000 and peaks at

[29] Internal Revenue Manual 1.2.13.1.10 P-4-21.
[30] See Appendix XV for a detailed explanation of how the FY 2011 corporation examination coverage rates were estimated and calculated.
[31] See Figure 8 for a detailed example of how the FY 2011 corporation coverage rates were calculated.
[32] The AIMS is the computer system used by IRS examination functions to control returns, input assessments/adjustments to Master File, and provide management reports.

38.24 percent for corporate returns with assets of $20 billion or more. The comparable non-NOL coverage rates range from 1.06 percent to 174.55 percent,[33] again indicating that an NOL return was considerably less likely to be selected for examination than a non-NOL return that reported a profit.

Figure 8: FY 2011 Total, NOL, and Non-NOL Corporate Examination Coverage Rate by Asset Class

Ending Assets	Total			NOL			Non-NOL
	Returns Examined FY 2011	Returns Filed PY 2010	Coverage	Returns Examined FY 2011	Returns Filed PY 2010	Coverage	Coverage
A	B	C	D = B/C	E	F	G = E/F	H = (B-E)/ (C-F)
Less Than $250,000	10,344	1,428,584	0.72%	2,195	661,245	0.33%	1.06%
$250,000 to < $1 Million	5,363	327,537	1.64%	626	141,906	0.44%	2.55%
$1 Million to < $5 Million	3,169	162,348	1.95%	426	67,028	0.64%	2.88%
$5 Million to < $10 Million	762	27,215	2.80%	187	11,624	1.61%	3.69%
SB/SE Division Subtotal	19,638	1,945,684	1.01%	3,434	881,803	0.39%	1.52%
$10 Million to < $50 Million	4,049	26,862	15.07%	707	12,362	5.72%	23.05%
$50 Million to < $100 Million	1,441	5,750	25.06%	482	2,698	17.87%	31.42%
$100 Million to < $250 Million	1,287	5,365	23.99%	431	2,339	18.43%	28.29%
$250 Million to < $500 Million	796	2,761	28.83%	233	1,166	19.98%	35.30%
$500 Million to < $1 Billion	681	1,863	36.55%	166	756	21.96%	46.52%
$1 Billion to < $5 Billion	1,191	2,069	57.56%	240	799	30.04%	74.88%
$5 Billion to < $20 Billion	570	656	86.89%	72	236	30.51%	118.57%
$20 Billion or More	430	326	131.90%	39	102	38.24%	174.55%
LB&I Division Subtotal	10,445	45,652	22.88%	2,370	20,458	11.58%	32.05%
Grand Total	30,083	1,991,336	1.51%	5,804	902,261	0.64%	2.23%

Source: TIGTA estimate based on computer analysis of the AIMS for FY 2011 and the BRTF for PY 2010.

An analysis of the filing and examination data for FY 2013 shows the composition of returns with NOLs within that data (see Figure 9). One observation from the data is that the percentage of corporate returns examined in which an NOL is present is considerably below the percentage of the population of corporate returns filed claiming an NOL, 24.5 percent versus 42.6 percent. Again, this same pattern exists for other years (FYs 2010 to 2012) in our analysis. This also accounts for the lower coverage rate seen for corporation return examinations in which an NOL is present.

[33] The coverage rate 174.55 percent results when return examinations from multiple years are closed and exceed the returns filed for a single year.

Figure 9: FY 2013 Corporate Examination Coverage of Returns With NOLs Compared With Non-NOL Returns

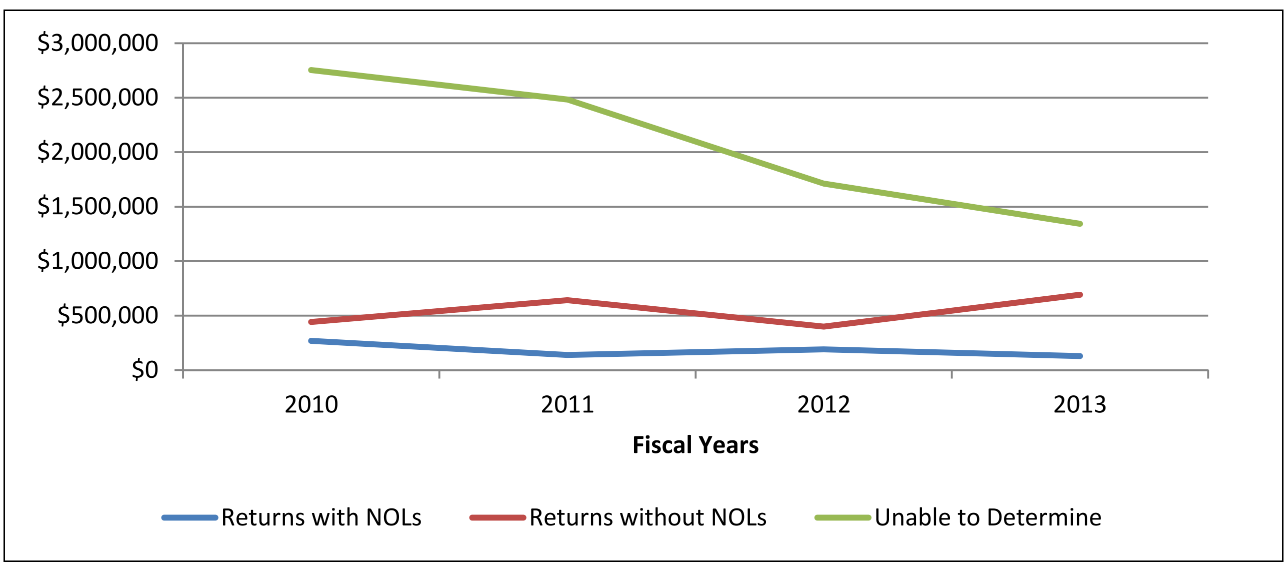
Description	All Returns	Percentage	Returns With NOLs	Percentage	Returns Without NOLs	Percentage
Returns Examined	27,518	100%	6,747	24.5%	20,771	75.5%
Returns Filed (PY 2012)	1,909,305	100%	813,910	42.6%	1,095,395	57.4%
Examination Coverage Rate	1.44%		0.83%		1.90%	

Source: TIGTA analysis of the AIMS for FY 2013 and the BRTF for PY 2012.

This apparent imbalance in coverage required further analysis. The issue to be analyzed was whether the rate of the examination of NOL returns was commensurate with the compliance risk. There are several possible measures to consider in determining whether the coverage rate is sufficient for the compliance risk. These include the average revenue yield per return examined and the no-change rate.

The second risk management strategy for analysis is from a revenue perspective. An analysis of examination data showed tax return examinations where an NOL is present yield significantly less revenue than non-NOL returns. For example, corporate return examinations in which an NOL was not present yielded nearly $691,833 per return in recommended assessments in FY 2013 compared to only $128,802 per return when an NOL was present (see Figure 10).

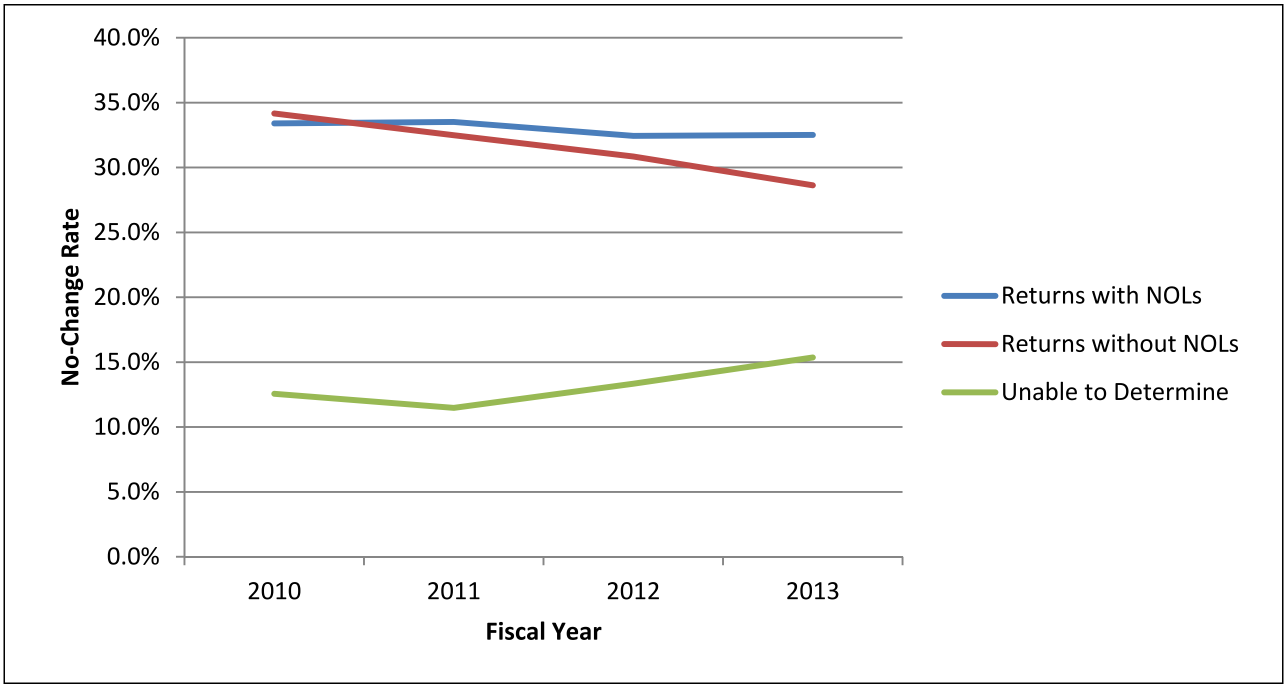
Figure 10: Corporate Income Tax Examination Dollars Per Return (FYs 2010 – 2013)



Source: TIGTA analysis of the AIMS for FYs 2010 to 2013.

Also, a factor to be considered is the no-change rate.[34] The corporation income tax return examination no-change rate indicates similar results for NOL and non-NOL returns (see Figure 11).

Figure 11: Corporate Income Tax Examination No-Change Rate (FYs 2010 – 2013)



Source: TIGTA analysis of the AIMS for FYs 2010 to 2013.

From a risk management approach, the lower examination coverage rate for NOL returns appears appropriate. Examining a substantially larger number of returns with NOLs would result in a slightly higher no-change rate and substantially less revenue. Figure 12 shows the examination results of corporation income tax returns for FY 2013.

[34] It should be noted that corporation income tax return examinations in general have a high no-change rate. The no-change rate is one indication that tax returns are in compliance. The higher the no-change rate, the higher the level of compliance in the tax return class. The lower the no-change rate, the less compliance in the tax return class. This is because the no-change rate recognizes when an examination takes place and the tax examiner either determined the tax return was acceptable as filed or was unable to find any discrepancies and accepted it as filed.

Figure 12: FY 2013 Actual Examination Results

Description	Returns Examined	Recommended Assessments	Dollars Per Return[35]
With NOLs	5,553	$715,235,797	$128,802
Without NOLs	17,250	11,934,116,397	691,833
Unable to Determine[36]	4,715	6,328,995,326	1,342,311
Total	27,518	$18,978,347,520	$689,670

Source: TIGTA analysis of the AIMS for FY 2013.

For comparison, if the IRS maintained ratable coverage based on the presence of NOLs in the return population, the revenue effect would have been substantial. If it is assumed that dollars per return would remain the same,[37] there would have been about $3.5 billion less in recommended assessments (see Figure 13). More specifically, the number of return examinations with NOLs would have increased by 6,170 ((27,518 × 42.6 percent) – 5,553) while a corresponding number of return examinations without NOLs would have decreased. This would have had the effect of reducing corporation recommended assessments by nearly $3.5 billion (6,170 × ($128,802 gained on returns with NOLs - $691,833 lost on returns without NOLs)) in FY 2013.

Figure 13: FY 2013 Theoretical Results If Examinations Mirrored Filing Population

Description	Returns Examined	Dollars Per Return[38]	Recommended Assessments
With NOLs	11,723	$128,802	$1,509,942,212
Without NOLs	11,080	$691,833	7,665,507,756
Unknown	4,715	$1,342,311	6,328,995,326
Total	27,518		$15,504,445,294
Less: Actual			18,978,347,520
Lost Revenue			($3,473,902,226)

Source: TIGTA computation based on analysis of the AIMS for FY 2013 and the BRTF for PY 2012 assuming ratable coverage based on the presence of NOLs in the return population and return productivity remaining constant.

35 Amounts rounded to nearest dollar for display purposes.
36 The 4,715 return examinations described as unable to determine described older return examinations for which we were unable to determine the NOL status of the examination because the tax returns were primarily filed prior to PY 2007, prior to Tax Year 2006, and therefore could not be matched because the data were not readily available and were outside the scope of our review. See Appendix XV.
37 This is a conservative assumption. It is more likely that the yield per return for NOL returns would actually decline because those additional returns would be selected from lower down on the yield curve than the present NOL returns, assuming that the IRS is already working the highest yielding NOL returns. This would have the effect of decreasing revenue even more than our $3.5 billion estimate.
38 Amounts rounded to the nearest dollar.

Finally, from a compliance risk management perspective, the IRS continually examines the largest corporations in the Coordinated Industry Case (CIC) program.[39] In PY 2010, 326 CIC corporation returns were filed, accounting for $354 billion (49.07 percent) of the $722 billion in NOLs filed on 902,261 corporation returns. Subsequently, in FY 2011, CIC program revenue agents examined 77 corporation NOL returns for an examination coverage rate[40] of about 23.6 percent (77 CIC corporate NOL returns examined/326 CIC corporate returns filed). This compares to a coverage rate of 0.64 percent (5,804 estimated corporate NOL returns examined[41]/ 902,261 corporate NOL returns filed) for all corporate NOL returns examined by the IRS.

The 77 CIC corporation NOL returns examined in FY 2011 represented only 1.58 percent (77 CIC corporate NOL returns examined/4,870 corporation NOL returns examined) of the corporation NOL returns examined, but accounted for $423 million (62.4 percent) out of the $678 million of the recommended assessments. The CIC program had a no-change rate on corporation NOL returns of 26 percent (20 CIC corporate NOL no-change returns/77 CIC corporate NOL returns examined) compared with 33.5 percent (1,632 no-change returns/4,870 corporate NOL returns examined) for all corporation NOL returns.

The CIC program also accounted for $913 million (95.7 percent) out of the $954 million of the corporation NOL carryforwards disallowed in FY 2011.[42] From these results, it is likely that most NOL returns are not abusive and are reporting actual economic losses. Contrast this with the activities of the same CIC program revenue agent cadre that examined a total of 1,330 returns, including NOLs, and made recommended assessments of $22.5 billion (88.5 percent) out of the $25.4 billion for the entire IRS corporate program. Therefore, a significant portion of NOL loss amounts are examined by the IRS. From a revenue perspective, the risk seems to be addressed.

However, from an overall compliance risk perspective, further attention may be required. The IRS examination risk assessment process includes identifying large, unusual, or questionable items, including corporate taxpayers who may be overly aggressive in generating NOLs. Also, anti-abuse provisions in the I.R.C. and Treasury Regulations severely restrict or limit the use of acquired losses and act as a legal backstop to discourage abusive use of the NOL provisions. However, the IRS has no separate program or process to identify these issues. The specifics of this compliance risk and the potential mitigating factors are discussed in the following section.

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[39] The CIC program is the IRS examination program that continually examines the largest corporations using a team approach. The number of taxpayers participating in the program ranged between 989 and 788 from PYs 2008 to 2013, respectively. In PY 2011, it consisted of approximately 844 taxpayers.
[40] The examination coverage rate is derived by dividing the number of returns examined by the total number of tax returns filed in the previous year.
[41] The 5,804 estimated corporate NOL returns examined consists of 4,870 corporate NOL returns examined plus 934 unknown returns allocated to NOL. See Appendix XV for details regarding the estimate.
[42] Internal Revenue Manual 4.4.12.4.58 paragraph (1) describes that "This item is used if you made adjustments to a credit that was carried forward but did not pick-up the carryforward year return." Therefore, the amount reflected is only NOL carryforwards when the subsequent year return was not picked up and examined.

Organisation for Economic Cooperation and Development Report on Aggressive Tax Planning Practices Utilizing Corporate Losses and the Potential Internal Revenue Service Risk Mitigation Factors

The OECD[43] issued a report, *Corporate Loss Utilisation Through Aggressive Tax Planning*,[44] in August 2011. The report described seven forms of tax schemes encountered by participating countries using aggressive tax planning and losses. The schemes included:

- Loss-shifting intended to transfer losses to profit-making operations, thus allowing the recipient to use the losses against its taxable income. Schemes encountered are based on the use of complex financial instruments such as swaps and after-tax hedges, non-arm's-length transfer pricing, and the acquisition of a loss-making company with no assets other than the tax losses carried forward.
- Shifting profits to a loss-making party to shift profits to loss-making operations so as to allow an upfront use of the losses.
- Circumventing time restrictions on the carryover of losses are schemes that rely on the use of financial instruments to "refresh" losses that would otherwise be lost due to the application of time restrictions in participating countries.
- Circumventing change of ownership/activity restrictions on the carryover of losses involve, for example, the injection of income into a loss-making company immediately prior to a major shareholding change which would result in the loss-making company forfeiting its loss carryforwards.
- Circumventing rules on the recognition or treatment of losses aimed at eluding the rules on the use of losses for group taxation (consolidation) purposes, the deductibility of foreign losses, or the carryover of losses.
- Creating artificial losses are those where the taxpayer seeks to generate losses for tax purposes with no economic loss incurred anywhere by anyone.

[43] The OECD is an international organization whose mission is to promote policies that will improve the economic and social well-being of people around the world. The OECD provides a forum in which governments can work together to share experiences and seek solutions to common problems. Member nations of the OECD are: Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.
[44] OECD, *Corporate Loss Utilisation Through Aggressive Tax Planning* (Aug. 2011).

- Dual/multiple use of the same loss that can be achieved through different means. One method is deducting capital losses on the shares of a subsidiary while the subsidiary's loss can also be deducted in future years.

A February 2011 OECD report highlighted the importance of disclosure initiatives in identifying aggressive tax planning schemes to tax authorities:

> *Disclosure initiatives can help to fill the gap between the creation/promotion of aggressive tax planning schemes and their identification by tax authorities. Mandatory early disclosure rules, for example, have proven to be very effective in providing governments with timely, targeted and comprehensive information on aggressive tax planning schemes, thus allowing timely policy and compliance responses.*[45]

In order to identify the use of aggressive tax planning, the IRS administrative return filing requirements and the I.R.C. contain disclosure and anti-abuse provisions. Beyond this, the IRS also has various information-sharing channels with other countries. Together, these provisions provide the framework to deter and detect the types of schemes identified by the OECD.

First, in recent years, the IRS has implemented a number of disclosure provisions applicable to large corporate income tax returns to increase transparency and to help identify uncertain and aggressive tax issues. The disclosures are used to identify, select, and plan income tax examinations. The OECD report describes a variety of potential abuses using NOLs. The IRS examination risk assessment process includes identifying large, unusual, or questionable items, including corporate taxpayers that may be overly aggressive in generating NOLs. With the anti-abuse provisions in the I.R.C. and Treasury Regulations severely restricting or limiting the use of acquired losses and acting as a legal backstop to discourage abusive use of the NOL provision, the IRS has not found widespread systemic or organized NOL abuses. The IRS disclosure forms include:

- **Form 1120, Schedule M-3, *Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More*** (see Appendix VII). Schedule M-3 can provide valuable information to the IRS. The purpose of the schedule is to disclose a detailed reconciliation between financial accounting and taxable income that may assist the IRS in identifying tax issues. However, Schedule M-3 was not designed to directly disclose all material issues to the IRS.

[45] OECD, *Tackling Aggressive Tax Planning Through Improved Transparency and Disclosure: Report on Disclosure Initiative* (Feb. 2011).

- **Form 1120, Schedule UTP, *Uncertain Tax Position Statement***[46] (see Appendix VIII). The concept behind Schedule UTP is that in a self-assessment tax system, taxpayers should disclose uncertain tax positions at the time they file their tax return. Specifically, if a corporation (or related party) records a "reserve" for a tax position in its audited financial statements, Schedule UTP requires the corporation to make a "concise description" of the tax position. In addition, disclosure on Schedule UTP is also required when a reserve is not recorded in the audited financial statements but in arriving at such conclusion, there was an assumption that there is a greater than 50 percent probability the tax position will be litigated.
- **Form 8275, *Disclosure Statement*** (see Appendix XI). Form 8275 is used to disclose items or positions, except those taken contrary to a regulation, that are not otherwise adequately disclosed on a tax return in order to avoid certain penalties.
- **Form 8275-R, *Regulation Disclosure Statement*** (see Appendix XII). Form 8275-R is used to disclose positions taken on a tax return that are contrary to Treasury Regulations. The form is filed to avoid the portions of the accuracy-related penalty due to disregard of regulations or to a substantial understatement of income tax for non-tax-shelter items if the return position has a reasonable basis. It can also be used for disclosures relating to the economic substance penalty and the preparer penalties for tax understatements due to positions taken contrary to regulations.
- **Form 8886, *Reportable Transaction Disclosure Statement*** (see Appendix IX). Form 8886 is used to disclose information for each reportable transaction and generally a separate Form 8886 is required for each reportable transaction. Loss transactions over a certain amount, among other reportable transaction categories, have to be disclosed on Form 8886. In addition, certain abusive loss-generating transactions that are designated by the IRS as reportable transactions, such as Distressed Asset Trust transactions (Notice 2008-34), also have to be disclosed on Form 8886.

One of the clear motivations behind the disclosure regime was to address the practical difficulties the IRS has in examining large corporations. The IRS spends substantial time identifying issues, and, in some cases, likely fails to identify all the issues.

> *Given the complex nature of tax law in general, coupled with the complexity inherent in modern corporations' business operations, it has become increasingly difficult for the IRS as a practical matter to efficiently audit large corporations. This issue has been exacerbated by the efforts of tax lawyers, accountants, and*

[46] A complete and accurate disclosure of a tax position on Schedule UTP will be treated as if the corporation filed Form 8275, *Disclosure Statement* (see Appendix XI), or Form 8275-R, *Regulation Disclosure Statement* (see Appendix XII), regarding the tax position. A separate Form 8275 or Form 8275-R need not be filed to avoid certain accuracy-related penalties with respect to that tax position.

investment bankers to (1) identify grey areas in the tax law that could be exploited, and (2) once exploited, make it an art form to minimize red flags in the corporate tax return that might arouse the IRS's interest.[47]

These disclosures increase the transparency of certain transactions that could be prone to aggressive tax planning. For example, the LB&I Division provided information that NOL transactions represented about 1 percent of the concise descriptions[48] being made on Schedule UTP in Tax Years 2010 and 2011 (see Figure 14).

Figure 14: Concise Descriptions of NOL Activity on Schedule UTP (Tax Years 2010 and 2011)

Description	Tax Year 2010		Tax Year 2011	
	Number	Percent	Number	Percent
I.R.C. Section 172 Concise Descriptions	6	0.12%	15	0.27%
I.R.C. Section 382 Concise Descriptions	36	0.72%	57	1.02%
Total NOL Concise Descriptions	42	0.84%	72	1.29%
Total Concise Descriptions	5,002	100.00%	5,582	100.00%

Source: IRS, LB&I Division, Planning Analysis Inventory and Research.

The LB&I Division also provided information that its Financial Data and Risk Assessment team:

…has done some limited review of NOL's with respect to the deferred tax asset and associated valuation allowance accounts reflected in the tax footnote of financial statements. A partial or full valuation allowance offsetting the deferred tax asset is an indication that the company's ability to utilize the deferred asset (NOL, credit carryforwards, for example) is limited. However, this information is not utilized to identify potential abusive transactions, but as a possible factor to consider a company for exam deselection…

[47] Harvey, J. Richard "Dick", *Schedule UTP: An Insider's Summary of the Background, Key Concepts, and Major Issues*, DePaul Business and Commerce Law Journal (Spring 2011).
[48] A concise description of the tax position includes a description of the relevant facts affecting the tax treatment of the position and information that reasonably can be expected to apprise the IRS of the identity of the tax position and the nature of the issue. In most cases, the description should not exceed a few sentences.

While the IRS is requesting this disclosure information under its general authority for Schedule M-3 and Schedule UTP, there are currently no specific civil or criminal penalties for not providing them. (Although there is a requirement to disclose information, the benefits of more specific disclosure penalty provisions should be considered, but further analysis is beyond the scope of this evaluation.)[49]

Statutory and Regulatory Anti-Abuse Limitations for Net Operating Losses

In addition to the disclosures, anti-abuse provisions in the I.R.C. and Treasury Regulations severely restrict or limit the use of acquired losses and act as a legal backstop to discourage abusive use of the NOL provision. These provisions include:

- I.R.C. Section 382 Limitations on NOL carryforwards and certain built-in losses following ownership change. An ownership change occurs, generally, if there is an equity structure shift or an ownership shift involving a 5 percent shareholder and the percentage of stock of the loss corporation owned by one or more 5 percent shareholders has increased by more than 50 percentage points over the lowest percentage of stock of the loss corporation owned by those shareholders during the testing period. The limitation results in an annual maximum limit upon the amount of the NOL carryover that may be used in any tax year. To the extent the annual limitation exceeds taxable income, the excess amount carries forward to increase the next year's limitation.
- Other Limitations:
    - I.R.C. Section 381 carryovers in certain corporate acquisitions govern the carryover of tax attributes in tax-free reorganizations and liquidations of controlled subsidiaries.
    - I.R.C. Section 383 special limitations on certain excess credits impose limits on the extent to which credits and net capital losses which arose before a change in corporate ownership can be used to offset income earned after the change.
    - I.R.C. Section 384 after an acquisition generally prevents for a five-year period the recognized built-in gain of one corporation from being offset by pre-acquisition losses of a different corporation.

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[49] Towery, Erin M., *How do disclosures of tax aggressiveness to tax authorities affect reporting decisions? Evidence from Schedule UTP* (Dec. 2012). The study postulates that firms could be modifying their financial reporting behavior for tax aggressiveness to avoid disclosing positions on Schedule UTP, thus affecting how tax authorities interpret both financial statement disclosures of tax aggressiveness and tax return disclosures of tax aggressiveness. Specifically, the research suggests: i) financial statement tax reserves could be less informative about tax aggressiveness under the Schedule UTP regime than in the recent past and ii) some aggressive positions are not disclosed on Schedule UTP.

- I.R.C. Section 269 acquisition made to evade or avoid income tax denies all of the tax benefits of an acquisition if its principal purpose is tax avoidance.

- Consolidated Return Regulations (Separate Return Limitation Year (SRLY Rules)) provide a limitation when a loss corporation joins in a consolidated return filing of another corporation. The loss corporation's NOLs generated in a year when the corporation filed a separate return – a Separate Return Limitation Year – can only offset income generated by the loss corporation in the future consolidated return.

- Corporate Equity Reduction Transactions Rules issued under I.R.C. Section 172(b)(1)(E) and (h) were enacted in response to the use of NOL carrybacks to finance leveraged buyout transactions and are intended to limit a corporation's ability to obtain tax refunds that result from an interest deduction from financing used to facilitate those transactions.

Each of these provisions also requires additional recordkeeping related to the use of losses that may act as an additional disincentive.

Next, another provision that limits corporate losses is the AMT. The AMT is designed as a parallel tax system to the normal Federal income tax system. The AMT ensures that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credits. The corporate AMT is computed on Form 4626, *Alternative Minimum Tax—Corporations* (see Appendix XIII).

In addition to the disclosure provisions, the anti-abuse provisions, and the AMT, the IRS also acquires intelligence regarding tax-motivated transactions through several other sources:

- The Office of Tax Shelter Analysis (OTSA);[50]

- The Exchange of Information (EOI) provisions of income tax conventions/treaties via headquarters operations, Joint International Tax Shelter Information Centre (JITSIC),[51] and IRS Attachés;

- Meetings and forums of international tax administrators; and

[50] The OTSA creation was announced in March 2000 in IRS Announcement 2000-12. The OTSA was created to ensure that the IRS has the information necessary to properly manage abusive tax shelters and issues of significant compliance risk to tax administration. This task is accomplished by collecting accurate and complete information from both internal and external sources that is timely analyzed and shared with officials in a position to take action.
[51] The JITSIC was created in Calendar Year 2004 and is comprised of the following member countries: Australia, Canada, China, France, Germany, Japan, Republic of Korea (South Korea), the United Kingdom, and the United States with offices in Washington, D.C., and London, UK. The objective of the JITSIC is to enhance each revenue authority's enforcement efforts through coordination and real-time exchanges of tax information consistent with the provisions of our bilateral income tax conventions. Representatives from member countries work together to supplement the ongoing work of member tax administrations in identifying and curbing abusive tax avoidance transactions, arrangements and schemes and to enhance activities against cross-border transactions involving tax compliance risks.

- IRS Technical Specialist of Pre-Filing and Technical Guidance that gather information on tax avoidance transactions, arrangements, and schemes identified by examiners and alert and disseminate that information to management and to other tax examiners.

The IRS reported to us that the IRS JITSIC team has not received inbound spontaneous or sent outbound specific referrals pertaining to NOLs in the period of our review between Calendar Years 2007 and 2012 (see Figure 15). The IRS also reported to us that other JITSIC countries could be doing work on NOLs and the IRS would not be privy to that information due to treaty secrecy between the other countries.

Figure 15: JITSIC Inbound and Outbound Activity (Calendar Years 2007 to 2012)

Calendar Year	Inbound Spontaneous Cases	Outbound Specific Cases
2007	No Information Available*	70
2008	No Information Available*	48
2009	No Information Available*	66
2010	2	41
2011	3	70
2012	9	52

*Source: IRS, LB&I Division, International. *The JITSIC did not differentiate between Specific and Spontaneous exchanges until Calendar Year 2010.*

Similarly, the EOI program controls spontaneous exchanges and specific requests for information sent to or received from a treaty or Tax Information Exchange Agreement partners.[52] However, the EOI system did not capture the underlying issue that was the subject of the specific request or spontaneous exchange. Therefore, LB&I Division officials were unable to identify cases involving NOLs. However, the IRS canvassed the Headquarters EOI team and the overseas posts for anecdotal information regarding the inappropriate use of NOLs and received negative responses. Figure 16 reflects the total EOI program exchanges.

[52] In 2010, a new tracking system was implemented and modeled on the LB&I Division's Issue Management System.

Figure 16: EOI Outbound and Inbound Exchange Activity (Calendar Years 2007 to 2012)

Calendar Year	Outbound Transaction Exchange		Inbound Transaction Exchange	
	U.S.-Initiated Specific Request	U.S.-Initiated Spontaneous Exchanges	Foreign-Initiated Specific Request	Foreign-Initiated Spontaneous Exchanges
2007	197	10†	1,088	300†
2008	236	10†	797	300†
2009	203	10†	914	300†
2010	165	9	843	309
2011	221	16	964	415
2012	238	7	1,029	249

Source: IRS, LB&I Division, International. †Information was unavailable to the IRS based on Government Accountability Office (GAO)[53] *report estimate.*

When specifically asked about the OECD-identified transaction, the IRS responded:

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In summary, the U.S. tax system contains several disclosure and anti-abuse provisions to detect and deter aggressive NOL transactions. Furthermore, the IRS participates in information sharing with other countries. The disclosure provisions are required from the largest corporations with the most substantial NOL dollar losses. These corporations are under constant scrutiny and are

[53] GAO, GAO-11-730, *IRS's Information Exchanges with Other Countries Could Be Improved through Better Performance Information*, p. 24 (Sep 2011).

subject to examination. In fact, the very largest corporations are examined on a constant basis. The combined effect is that the IRS has safeguards in place to deter and detect aggressive tax planning for the largest dollar risks.

The Internal Revenue Service Could Improve the U.S. Government Financial Statements by Disclosing the Net Present Value of Net Operating Loss Carryforwards

In 1993, the GAO estimated the NOL carryforward for more than two-thirds of corporations[54] when analyzing an IRS proposal to require NOL carryforward amounts on corporate tax returns. The GAO described its estimate as (please note the GAO discussion is using the term NOL carryover when actually referring to the NOL carryforward only):

> *Our estimate of NOL carryovers applies to over two-thirds of all corporations. The estimated carryover of $160 billion in 1985 increased to $246 billion in 1989—or 54 percent in current dollars. Over this time, total receipts (i.e., the amount of gross receipts and other forms of positive income before deductions) for the corporations covered by our estimate grew from $0.95 trillion to $1.25 trillion (32 percent).*

This is in contrast with what we found from PY 2007 to PY 2012. The NOL carryforward of $1.686 trillion in PY 2007 increased to $1.963 trillion in PY 2012—16.4 percent in current dollars. During this time, total receipts for all corporations filing Form 1120 grew from $17.5 trillion to $46.3 trillion (164.98 percent), while corporate net income contracted from $1.1 trillion to $675 billion (-38.32 percent).

In 1994, the IRS changed Form 1120 to include the NOL carryforward amount.[55] The change allowed tax policy decision makers to determine with greater certainty the future fiscal effect of the carryforward. However, a search for the NOL carryforward showed that the amounts are not commonly available in U.S. Government publications.

The importance of the nearly $2 trillion in corporate NOL carryforwards is that it represents a future reduction to the Federal Government's corporate income tax revenues. As a corporation with an NOL carryforward earns net income in future years, that net income will be offset by the NOL carryforward taken as a Net Operating Loss Deduction (NOLD), which will reduce or eliminate the corporation's future taxable income and income tax. We estimate that the net present value of the stock of nearly $2 trillion in NOL carryforward will reduce future Federal Government corporation income tax revenues in a range between approximately $371 billion to

[54] GAO, GAO/GGD-93-131, *Corporate Net Operating Losses* (Sep. 1993).
[55] Form 1120, Schedule K Other Information, Item 15 that states: "Enter the available NOL carryover from prior tax years (Do not reduce it by any deduction on line 29a (NOLD))."

$414 billion.[56] This reduction in the Federal Government's future corporation income tax revenues is not reflected in Federal financial reporting statements.

More specifically, the Financial Report of the U.S. Government treats presentations of very material amounts inconsistently. The Statement of Federal Financial Accounting Standard (SFFAS) 7: *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting* requires that other accompanying information to the annual Financial Report of the U.S. Government include available information on the size of the Tax Gap.[57] Therefore, the $450 billion Federal Tax Gap[58] is presented in the FY 2013 Financial Report of the U.S. Government. In contrast, there is no specific disclosure requirement for the nearly $2 trillion in corporation NOL carryforwards or its potential effect to reduce future U.S. Government tax revenues in the same manner as the Tax Gap.

For background, several concepts of Federal financial accounting are important to understand. First, revenue is an inflow of resources that the Government demands, earns, or receives by donation. Revenue comes from two sources: exchange transactions and non-exchange transactions. Exchange revenue arises when a Government entity provides goods and services to the public or to another Government entity for a price comparable to the private sector's accrual accounting for earned revenue. In contrast, non-exchange revenues include income taxes, excise taxes, employment taxes, duties, fines, penalties, and other inflows of resources arising from the Government's power to demand payments, as well as voluntary donations. Non-exchange revenue is recognized when a reporting entity (the IRS, *etc.*) establishes a specifically identifiable, legally enforceable claim to cash or other assets. It is recognized to the extent that the collection is probable, *i.e.*, more likely than not, and the amount is measurable, *i.e.*, reasonably estimable.[59]

The second concept is when revenue is recognized. For taxes and duties, inherent and practical limitations on the assessment process delay the time when the power to demand payment becomes a legally enforceable claim. For this reason, the method of accounting for taxes and duties can best be characterized as a modified cash basis of accounting, rather than an accrual basis. The result is that it is unnecessary to set up accrual accounts to reflect the Tax Gap or the tax effect of corporations' NOLs as a sacrifice of revenues because on a cash basis these reductions would already be included.[60]

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[56] See Appendix IV for details on how this estimate was calculated.
[57] The Tax Gap is the estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.
[58] The $450 billion Tax Gap is an estimate of the 2006 Tax Gap.
[59] As explained in paragraph 44 of SFFAS Number 1, *Accounting for Selected Assets and Liabilities*, "More likely than not" means more than a 50 percent chance. "Not probable" means the converse, *i.e.*, 50 percent or less.
[60] In theory, under a full accrual accounting system, both the Tax Gap and the NOL carryforward would be accrued as contra-revenue accounts and the associated contingent liabilities would be disclosed under the SFFAS 5, but this is not applicable due to the modified cash basis of accounting used for taxes and duties.

The third concept pertains to claims against the Government. Specifically, SFFAS 7 issued in May 1996, contains a discussion about unasserted claims for refunds. This states that unasserted claims for refund are not recognized for financial accounting purposes because they have not been filed. However, in a footnote to the discussion, NOL carryforwards are explicitly excluded from being classified as an unasserted claim. The footnote states:

> *Future income taxes from corporations may be reduced by more than $100 billion dollars as a result of net operating loss carryforwards and tax credit carryforwards. Information in returns filed by corporations and in their financial statements appear to provide the basis for a reasonable estimate of the amount of potential reduced future income tax revenue attributable to these provisions of tax law. Information about net operating loss carryforwards is not an unasserted claim as described here.*

For clarification, the NOL carryforwards are not a claim on future revenue. Rather, the NOL carryforwards are a reduction of future revenue. The taxpayer files no claim for refund to take an NOL carryforward. All they will do is file their future tax returns and take a NOLD equal to the lower of their NOL carryforward or net income before the NOLD.

Without question, a fundamental principle of accounting is the full disclosure principle of material information. The Government financial reporting requirements already consider the $450 billion Tax Gap and its impact on Federal tax revenues important enough to disclose in the Financial Report of the U.S. Government. However, the Tax Gap is a static estimate from a Tax Year 2006 estimate,[61] whereas, the NOL carryforward is an actual amount from filed tax returns. Both amounts are significant to overall Government revenue. However, disclosure of similar items with similar impacts is inconsistent. The nearly $2 trillion corporate NOL carryforward also continues to grow, but is not disclosed. In fact, as stated previously, we estimate the present value of the corporate NOL carryforward ranges from about $371 billion to $414 billion for PY 2012.

Recommendation

Recommendation 1: The Chief Financial Officer should include as a note in other accompanying unaudited information to the financial statements the amount, net present value, and description of the corporate NOL carryforward amounts' impact on future tax revenues.

> ***Management's Response:*** The IRS disagreed with our recommendation citing:
>
> - The disclosure is not required by existing Federal accounting standards;

[61] TIGTA, Ref. No. 2013-IE-R008, *The Internal Revenue Service Needs to Improve the Comprehensiveness, Accuracy, Reliability, and Timeliness of the Tax Gap Estimate* (Aug. 2013).

- It is unclear the value of reporting the impact of the NOL carryforward as a separate element affecting revenue collections in the financial statements; and
- The benefits of deriving a meaningful calculation would be outweighed by the burden of doing so.

Office of Inspections and Evaluations Comment: TIGTA agrees that NOL disclosures are not required; however, we continue to believe that due to the material impact of NOL carryforwards on future corporate tax revenue, disclosure is warranted. TIGTA concurs with the IRS that any estimates of the effect of NOL carryforwards will be based on estimates and assumptions. However, the IRS currently presents in its financial statements unaudited information on the IRS Tax Gap, which is also based on estimates and assumptions. Thus excluding similar disclosures on NOL because it is based on estimates and assumptions is not consistent with other financial statement disclosures. Although the GAO performs certain limited procedures such as making inquiries to management, it does not express an opinion or provide any assurances on the Tax Gap information and would not be required to do for any NOL carryforward estimates.

Appendix I

Detailed Objective, Scope, and Methodology

Objective

The objective of our evaluation was to evaluate the IRS plans, activities, and programs to administrate the tax laws for corporate NOLs and NOL carryovers.

This evaluation was performed because of the increasing percentage of corporation returns filed reporting NOLs and the potential impact of those NOLs as carryforwards on future Federal corporation tax revenues.

Scope

Our evaluation relied on IRS data that are the product of IRS management and were secured from TIGTA's Data Center Warehouse[1] and consisted of the following files:

- The BRTF[2] for PYs 2007 to 2012 used to evaluate on an annual basis the corporation return volume and the amount of net income/loss reported for all corporation returns filed and those with NOLs, NOL carryforwards, and NOLDs.
- The BMF[3] for PYs 2007 to 2012 used to evaluate the volume and amount of carryback refund transactions, and the related interest paid on an annual basis.
- Closed corporation AIMS[4] for FYs 2010 to 2013 used to evaluate the volume of corporate return examinations closed and examination returns results for returns with and without NOLs on an annual basis.[5]

As part of our data verification process for the AIMS and the BRTF, we checked the total number of corporation returns examined or corporation returns filed each year against agency totals reflected in the appropriate IRS Data Book to determine if the numbers were similar.

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[1] TIGTA's Data Center Warehouse is a collection of IRS databases containing various types of taxpayer account information that is maintained by TIGTA for the purposes of analyzing data for ongoing projects.
[2] The BRTF is a computer file of the transcribed or transmitted line items on all business returns and their accompanying schedules or forms.
[3] The BMF is the IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.
[4] The AIMS is the computer system used by the IRS examination functions to control returns, input assessments/adjustments to the Master File, and provide management reports.
[5] Closed AIMS for FYs 2010 to 2013 were modified by adding an indicator showing an NOL was present on the return by matching the BRTF for PYs 2007 to 2012 using the common fields of Taxpayer Identification Number, Master File Transaction, and Tax Period.

We also received information from IRS officials with respect to the JITSIC and EOI forums. We reviewed the information as to reasonableness and accepted it, but no extensive verification or testing of the information was conducted.

Methodology

I. To determine the size, amount, and rate of occurrence of NOLs, NOL carryforwards, and NOLDs in the corporation filing population, obtained copies of the corporation BRTF for PYs 2007 to 2012 from the TIGTA Data Center Warehouse. We added identifiers that split each processing year file into NOL and non-NOL returns, NOL carryforward and non-NOL carryforward returns, and NOLD and non-NOLD returns. We also added an identifier to the filing population for the Asset Level based on its total ending assets. We then analyzed each processing year by asset class and NOL returns and non-NOL returns, NOL carryforward returns and non-NOL carryforward returns, or NOLD returns and non-NOLD returns to determine the number of returns, the amount of net income/loss reported, and the percentage of corporation returns filed.

II. To determine the present value of NOL carryforwards, we started out to treat it as the present value of an annuity recovered over a 20-year life. We started our analysis using the amount of NOL carryforwards reported to the IRS in PY 2012 on Schedule K, *Other Information*, Form 1120, *U.S. Corporation Income Tax Return*. We then reduced the amount of NOL carryforwards by those amounts that are lost or never used, based on academic research. The remaining NOL carryforward was then split into a high and low estimate for the amount recoverable in years one to 10 and years 11 to 20 based on academic research. Economists with the Department of the Treasury's Office of Tax Policy upon reviewing our preliminary computation directed our attention to additional academic research that pointed out that historically most of the NOL carryforward recovery takes place in the first four years following the NOL. Based on this information, we adjusted our approach to computing the net present value for an uneven series of recoveries for years one to 10 based on the percentage of historical recoveries found in the academic research rather than using a simple annuity. Therefore, for each year in years one to 10, we multiplied the high estimate by the historical recovery percentage to determine the annual recovery amount. The annual recovery amount for each year was then multiplied by the Present Value Interest Factor (PVIF) for that year to determine the net present value. The net present values for the high estimate of years one to 10 were then summed to determine the net present value of the high estimate for years one to 10. The process was then repeated for the low estimate. For years 11 to 20, the high and low estimates were each divided by 10 to determine the average annual recovery amount. The average annual recovery amount for the high estimate for years 11 to 20 was then multiplied by the Present Value Interest Factor of an Annuity (PVIFA) to determine the net present value of the high estimate recovery for years 11 to 20. The process was then repeated for the low estimate. The net present values for the high estimate for years one to 10 and 11 to 20 were summed to determine the net present value of the high estimate of NOL carryforwards reported in PY 2012. The process was repeated to determine the low estimate.

III. To determine the number of transactions and cost to the Federal Government of carrybacks and related interest, obtained copies of the IRS's corporation BMF for PYs 2007 to 2012 from the TIGTA Data Center Warehouse. We then analyzed each processing year to determine the number and amount of carrybacks by cycle period and the related interest paid, if any, on those carrybacks, also based on cycle period.

IV. To determine the policy considerations and legal issues for present tax treatment of allowing NOLs and NOL carryovers in the tax code, reviewed legal, economic, and historical articles describing the origin and purpose of the NOL provisions; reviewed economic articles describing the importance of NOL policy and provisions in economic stabilization and in reducing risk and fostering research and technological advance; reviewed the legal provisions restricting the use of losses to the entity that economically incurred the losses and the AMT that attempts to restrict the use of non-economic losses; and reviewed Office of Tax Policy and IRS 2012-2013 and 2013-2014 Priority Guidance Plans with respect to NOLs.

V. To determine how NOLs can be exploited improperly through aggressive tax planning to reduce corporate income taxes and what the IRS has in place to combat the problem, reviewed the Organisation of Economic Cooperation and Development's reports *Corporate Loss Utilisation Through Aggressive Tax Planning* (August 2011) and *Tackling Aggressive Tax Planning Through Improved Transparency and Disclosure: Report on Disclosure Initiative* (February 2011); reviewed the various IRS disclosure forms and instructions that may be required of large corporations; and reviewed the legal and academic literature available on the IRS large corporation disclosure initiatives. We solicited information from the IRS regarding its experience with the various schemes using operating losses identified by the OECD and the use of the JITSIC and EOI forums.

VI. To determine the examination coverage and examination results of returns filing NOLs whose examinations were closed, obtained copies of the closed corporation AIMS for FYs 2010 to 2013 from the TIGTA Data Center Warehouse. For each fiscal year, we added an NOL indicator that indicated if the return was filed with an NOL by matching the NOL returns filed in PYs 2007 to 2012 to the fiscal year using the common fields of the Taxpayer Identification Number, Master File Transaction Code, and Tax Period. We then analyzed each fiscal year by asset class and NOL and non-NOL returns to determine the number of return examinations, number of no-change return examinations, and examination results. We were also able to compute the coverage rates by asset class and NOL and non-NOL status by taking the number of returns examined and dividing it by the number of returns filed in Step I. in the prior processing year.

VII. To determine disclosure requirements for the financial statements of the United States and the possible need to disclose the corporate NOL carryforward in the financial statements, reviewed the disclosures appearing in the Financial Report of the U.S. Government. We also reviewed SFFAS 7 *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, SFFAS 1 *Accounting for Selected Assets and Liabilities*, and SFFAS 5 *Accounting for Liabilities of the Federal Government*.

VIII. To validate our *Estimated Cost in Tax Revenue of Processing Year 2012 Net Operating Loss Carryforwards of $1.963 Trillion* (Appendix IV), consulted with the Department of the Treasury Office of Tax Policy.

Appendix II

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Appendix III

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Appendix IV

Estimated Cost in Tax Revenue of Processing Year 2012 Net Operating Loss Carryforwards of $1.963 Trillion

The future impact on the Federal Government's corporate tax revenues of the NOL carryforward can be analyzed as an annuity payable over a 20-year period (the carryforward period), provided we know two factors: the cost of money and the amount of NOLs that will expire unused. Because the Federal Government self-finances, the best reflection for a long-term liability such as the NOL carryforward would be the 30-year Treasury Bond rate.

To estimate the amount of NOLs that will expire, we employed the concepts presented in an academic paper "*Partial Loss Refundability: How Are Corporate Tax Losses Used?*" in which the authors describe the breakdown of how NOLs are used:

> *…Using corporate tax return data for tax years 1993–2003 we construct a unique dataset to measure how quickly corporations use tax losses. For most tax years, we find that approximately 10-15 percent of losses generated in a given year are carried back for an immediate tax refund. Carryback firms suffer no inherent penalty from the partial refund regime. Over a ten-year window, we find that approximately 40-50 percent of losses are used as a loss carryforward deduction, approximately 25-30 percent are lost (i.e., the firm no longer exists) and 10-20 percent remain unused….*[1]

In addition to providing information regarding the amount of NOLs that expire unused, the authors also state that 40 to 50 percent is used as an NOL carryforward during the first 10 years. Furthermore, 10 to 20 percent remains unused at the end of the first 10 years, presumably to be used in years 11 to 20, or to expire. This permitted us to split our analysis into two periods rather than one to get a more precise measurement.

[1] Cooper, Michael and Matthew Knittel, *Partial Loss Refundability: How Are Corporate Tax Losses Used?*, National Tax Journal Vol. LIX, No. 3 September 2006.

Figure 1: Disposition of NOLs (Billions)

Tax Year	NOL	Carryback Refund	NOL Used as Carryforward Deduction, Number of Years Until Used												Final NOL Disposition		
			1	2	3	4	5	6	7	8	9	10	11	12	Used[2]	Lost[3]	Remain
1993	71.0	10.4	2.8	6.4	3.7	5.4	2.3	1.7	2.2	1.2	0.8	0.6	0.9		38.3	21.3	11.4
1994	64.4	11.7	3.9	2.5	3.1	2.5	1.8	1.9	1.4	1.1	0.7	1.0			31.8	19.0	13.6
1995	73.3	12.1	2.1	3.0	2.0	2.3	1.7	2.2	1.4	1.4	1.3				29.5	26.5	17.2
1996	80.5	12.9	2.1	2.6	3.1	3.7	1.9	1.8	1.5	1.8					31.2	31.4	17.9
1997	97.1	15.7	2.6	3.2	5.3	2.2	1.9	1.6	1.5						34.0	39.4	23.6
1998	141.9	18.9	5.8	7.9	3.7	3.2	3.9	3.5							46.8	53.3	41.7
1999	180.6	20.8	11.1	5.6	3.9	5.4	6.8								53.6	55.8	71.2
2000	245.5	26.0	5.4	5.4	5.9	8.8									51.6	67.4	126.5
2001	370.3	88.1	8.0	8.3	7.6										112.0	66.3	192.0
2002	365.9	66.3	5.1	11.4											82.7	57.7	225.4
2003	243.1	28.0	5.6												33.6	17.2	192.4
2004	188.3	13.7													13.7	0.0	174.6
Utilization of Pre-existing NOL Stocks																	
Pre-1993[4]	262.7		27.3	25.3	25.7	19.6	17.7	11.1	9.0	7.0	4.7	2.5	1.8	1.5	153.2	91.6	17.9
New Firms[5]	162.7		14.0	16.5	11.9	13.1	7.0	4.8	2.7	2.0	0.7	0.5	0.2	0.0	73.4	46.7	42.6

Source: *The Implications of Tax Asymmetry for U.S. Corporations by Michael Cooper and Matthew Knittel.*[6]

Figure 2: NOLDs (Billions)

	Tax Year NOLD													
Year	2004	2003	2002	2001	2000	1999	1998	1997	1996	1995	1994	1993	Average	Percent
1	5.6	5.1	8.0	5.4	11.1	5.8	2.6	2.1	2.1	3.9	2.8	27.3	6.82	16%
2	11.4	8.3	5.4	5.6	7.9	3.2	2.6	3.0	2.5	6.4	25.3		7.42	17%
3	7.6	5.9	3.9	3.7	5.3	3.1	2.0	3.1	3.7	25.7			6.40	15%
4	8.8	5.4	3.2	2.2	3.7	2.3	2.5	5.4	19.6				5.90	14%
5	6.8	3.9	1.9	1.9	1.7	1.8	2.3	17.7					4.75	11%
6	3.5	1.6	1.8	2.2	1.9	1.7	11.1						3.40	8%
7	1.5	1.5	1.4	1.4	2.2	9.0							2.83	6%
8	1.8	1.4	1.1	1.2	7.0								2.50	6%
9	1.3	0.7	0.8	4.7									1.88	4%
10	1.0	0.6	2.5										1.37	3%
Total	49.3	34.4	30.0	28.3	40.8	26.9	23.1	31.3	27.9	36.0	28.1	27.3	43.26	100%

Source: TIGTA analysis of the use of NOL carryforwards as NOLDs from data in The Implications of Tax Asymmetry for U.S. Corporations by Michael Cooper and Matthew Knittel.

In a subsequent paper "*The Implications of Tax Asymmetry for U.S. Corporations*,"[7] the authors provide additional detail regarding the usage of the NOL carryforward in the first 10-year period. The table from their paper (reproduced in Figure 1) shows the usage of NOL carryforward over time. This allows additional precision in our computation. This means that NOLDs taken in Tax

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[2] Used NOLs equal to the sum of carryback refunds and loss carryforward deductions.
[3] Lost NOLs are stocks of NOLs that disappear due to firm termination or a merger/acquisition.
[4] Pre-existing NOL stock brought forward into Tax Year 1993. Carryback refunds are not observable.
[5] Pre-existing NOL stock for firms that first appear in our dataset after Tax Year 1993. Carryback refunds are not observable.
[6] Cooper, Michael and Matthew Knittel, *The Implications of Tax Asymmetry for U.S. Corporations*, National Tax Journal Vol. LXIII, No. 1 March 2010, p 41.
[7] Cooper, Michael and Matthew Knittel, *The Implications of Tax Asymmetry for U.S. Corporations,* National Tax Journal Vol. LXIII, No. 1 March 2010.

Year 2004 will use NOL carryforwards of $5.6 billion in Tax Year 2003, $11.4 billion in Tax Year 2002, $7.6 billion in Tax Year 2001, and so on as illustrated in Figure 2. As a consequence, about 24 to 30 percent ((16 percent + 17 percent + 15 percent + 14 percent) × (40 to 50 percent))) of the NOL is used as a carryforward in the first four years immediately after the loss.

To compute the present tax value of the PY 2012 NOL carryforward, we used the formula for the PVIF where (k) is the cost of money and (n) is the period the sum is due. The formula is:

$$\text{PVIF}_{,\ k\%,n} = \frac{1}{(1+k)^n}$$

We also used the formula for the PVIFA where (k) is the cost of money and (n) is the number of annuity periods. The formula is:

$$\text{PVIFA}_{,\ k\%,n} = \frac{1-\frac{1}{(1+k)^n}}{k}$$

For the purposes of our calculation, we made the following assumptions and adjustments:

- We assumed the relationships described in the NOL data from the papers from Cooper and Knittel for Tax Years 1993 through 2004 are also present in the PY 2012 data. We acknowledge that these relationships are subject to change over time due to changes in technology, changes in the business cycle, the impact of changing weather patterns on business activities, and changes due to the recent impact of the Great Recession, among other things. Therefore, some uncertainty exists surrounding our calculation of the present value of the NOL carryforwards. However, we believe this represents the best descriptive data available to us to make such a calculation.
- We know that Total NOL carryovers = NOL carryforwards + NOL carrybacks. To "gross up" the $1,963 trillion NOL carryforwards to the total NOL carryovers, we selected 10 percent for the NOL carryback number due to work with NOL carrybacks also discussed in this report.[8] Grossing up the number of NOL carryforwards to total NOL carryovers allows us to use the same percentages described in the paper "*Partial Loss Refundability: How Are Corporate Tax Losses Used*." Thus, to gross up NOL carryforwards to NOL carryovers, we created the algebraic formula:

  $$x = \$1.963 \text{ trillion} + 0.1x$$

  where: x represents total NOL carryovers

[8] During our work with NOLs, we looked at the number of returns and the amount of NOLs that would be subject to carryback because the NOL return did not have a pre-existing NOL carryforward. Between PYs 2007 to 2012, only about 3.8 percent of returns with NOLs could carryback their NOLs, and only about 16.4 percent of the NOLs could be carried back. However, this does not mean that 16.4 percent were carried back. These NOL carrybacks would have been reduced due to the available tax for refund and the remainder would have become NOL carryforwards.

0.1x represents NOL carryback and

$1.963 trillion is the amount of NOL carryforwards

Solving for x, we get $2.182 trillion total NOL carryovers as follows:

$$x = \$1.963 \text{ trillion} + 0.1x$$
$$0.9x = \$1.963 \text{ trillion}$$
$$x = \$1.963 \text{ trillion}/0.9$$
$$x = \$2.182 \text{ trillion}$$

- To estimate the high end of the range for the present value of NOL carryforwards, we used the marginal corporate tax rate of 35 percent and assumed that, based on the paper *Partial Loss Refundability: How Are Corporate Tax Losses Used?*, 25 percent of the total NOL carryovers were lost or expired, 50 percent of the NOL carryovers were used as loss carryforward deductions in years one through 10, and 15 percent of the NOL carryover losses were used in years 11 to 20 with no additional losses.[9]
- To estimate the low end of the range, we used the marginal corporate tax rate of 35 percent[10] and assumed, based on the same paper, that 30 percent of total NOL carryovers were lost or expired, 40 percent of NOL carryovers were used as loss carryforward deductions in years one through 10, and 20 percent of NOL carryover losses were used in years 11 to 20 with no additional losses.
- We assumed the cost of money (k) for our PVIFA computation was equal to the average yield of a 30-year Treasury Bond in Calendar Year 2012 of 2.92 percent.
- We followed the conclusions presented in the academic paper[11] and split our present value computation into two periods: years one to 10 and years 11 to 20. For years one to 10, we computed the PVIF for each year using the formula ($1/(1+k)^n$) and multiplied it against the NOL carryover used in each of those years based on historical averages we

[9] The assumption that there would be no additional NOL carryforwards that would be lost or would expire in years 11 to 20 is unlikely. However, we have no data on which to base such an estimate. It is likely that some percentage of NOL carryforwards during that period would be lost or expire unused, having the effect of reducing the present value of the NOL carryforward calculation.
[10] It was suggested during discussion of this report that we should consider using the effective tax rate rather than the maximum statutory tax rate; however, inclusion of the effective tax rate would have had the effect of double counting NOLs because their inclusion as NOLDs is one of the reasons for the difference between the statutory and effective tax rates.
[11] Cooper, Michael and Matthew Knittel, *Partial Loss Refundability: How Are Corporate Tax Losses Used?*, National Tax Journal Vol. LIX, No. 3 September 2006.

computed in Figure 2.[12] For years 11 to 20, we computed the PVIFA for a 10- and 20-year period using the formula $(1-(1/(1+k)^n))/k$ and derived the PVIFA formula for years 11 to 20 by subtracting PVIFA,2.92%,10 from PVIFA,2.92%,20 as shown:

PVIFA,2.92%,20	14.98811348
Less: PVIFA,2.92%,10	8.56513525
PVIFA,2.92%,20-10	6.42297823

Based on this information and assumptions, our computation follows: Figure 3 shows how the PY 2012 NOL carryforward is grossed up to the original amount of the total NOL carryover to allow for allocation into the categories NOLs never used, NOL carryforwards (NOL C/Fs) used in years one to 10, and NOL C/Fs used in years 11 to 20, based on the academic paper *Partial Loss Refundability: How Are Corporate Tax Losses Used?*

[12] Cooper, Michael and Matthew Knittel, *The Implications of Tax Asymmetry for U.S. Corporations,* National Tax Journal Vol. LXIII, No. 1 March 2010, p 41.

Figure 3: Allocation of PY 2012 NOL Carryforwards

Descriptions		Low Range	High Range
Tax Value of NOL Carryovers			
NOL Carryforwards	$1,963,465,082,345		
Divided by: Gross Up Rate to Include Carrybacks	90%		
NOL Carryovers	2,181,627,869,272	2,181,627,869,272	2,181,627,869,272
Corporate Tax Rate		35%	35%
Tax Value of NOL Carryover		763,569,754,245	763,569,754,245
Tax Value of NOLs Never Used (Expired)			
Tax Value of NOL Carryover		763,569,754,245	763,569,754,245
Portion of NOLs Never Used (Expired)		30%	25%
Tax Value of NOLs Never Used (Expired)		229,070,926,274	190,892,438,561
Tax Value of NOL C/Fs Used in Years 1 to 10			
Tax Value of NOL Carryover		763,569,754,245	763,569,754,245
Portion of NOL C/Fs Used in Years 1 to 10		40%	50%
Tax Value NOL C/Fs Used in Years 1 to 10		305,427,901,698	381,784,877,123
Tax Value of NOL C/Fs Used in Years 11 to 20			
Tax Value of NOL Carryover		763,569,754,245	763,569,754,245
Portion of NOL C/Fs Used in Year 11 to 20		20%	15%
Tax Value NOL C/Fs Used in Years 11 to 20		152,713,950,849	114,535,463,137

Source: TIGTA computation. Assumptions: NOL carrybacks were 10 percent of total NOL carryovers, statutory corporate tax rate of 35 percent, and the application of NOL carryforwards based on percentages in Partial Loss Refundability: How Are Corporate Tax Losses Used? by Michael Cooper and Matthew Knittel.

In Figure 4, we compute the low and high range of the present value of the NOL C/Fs allocation for years one to 10 computed in Figure 3. The annual NOL C/Fs used is computed by multiplying the tax value by the historical percentage for the specific year. The NOL C/Fs used is then multiplied by the $PVIF_{,2.92\%,n}$ to obtain the present value. The present values for each year are then summed.

Figure 4: Present Value Calculation of NOL Carryforwards Years One to 10

Low Range

Year (n)	Tax Value of NOL C/F Used in Years 1 to 10	Historical Percentage[13]	NOL C/Fs Utilized	$PVIF_{,2.92\%,n}$	Present Value
Year 1	$305,427,901,698	16%	48,868,464,272	0.9716	47,480,599,886
Year 2	305,427,901,698	17%	51,922,743,289	0.9441	49,020,261,939
Year 3	305,427,901,698	15%	45,814,185,255	0.9173	42,025,352,134
Year 4	305,427,901,698	14%	42,759,906,238	0.8913	38,111,904,430
Year 5	305,427,901,698	11%	33,597,069,187	0.8860	29,767,003,299
Year 6	305,427,901,698	8%	24,434,232,136	0.8414	20,558,962,919
Year 7	305,427,901,698	6%	18,325,674,102	0.8175	14,981,238,578
Year 8	305,427,901,698	6%	18,325,674,102	0.7943	14,556,082,939
Year 9	305,427,901,698	4%	12,217,116,068	0.7718	9,429,170,181
Year 10	305,427,901,698	3%	9,162,837,051	0.7499	6,871,211,505
Total Years 1 to 10			305,427,901,698		272,801,787,811

High Range

Year (n)	Tax Value of NOL C/F Used in Years 1 to 10	Historical Percentage[14]	NOL C/Fs Utilized	$PVIF_{,2.92\%,n}$	Present Value
Year 1	$381,784,877,123	16%	61,085,580,340	0.9716	59,350,749,858
Year 2	381,784,877,123	17%	64,903,429,111	0.9441	61,275,327,424
Year 3	381,784,877,123	15%	57,267,731,568	0.9173	52,531,690,168
Year 4	381,784,877,123	14%	53,449,882,797	0.8913	47,639,880,537
Year 5	381,784,877,123	11%	41,996,336,483	0.8860	36,368,827,395
Year 6	381,784,877,123	8%	30,542,790,170	0.8414	25,698,703,649
Year 7	381,784,877,123	6%	22,907,092,627	0.8175	18,726,548,223
Year 8	381,784,877,123	6%	22,907,092,627	0.7943	18,195,103,674
Year 9	381,784,877,123	4%	15,271,395,085	0.7718	11,786,462,727
Year 10	381,784,877,123	3%	11,453,546,314	0.7499	8,589,014,381
Total Years 1 to 10			381,784,877,123		340,162,308,034

Source: TIGTA computation. Tax value of NOL C/Fs used in years one to 10 computed from Figure 3, historical percentage utilized computed from Figure 2, and $PVIF_{,2.92\%,n}$.[15]

In Figure 5, we compute the low and high range of the present value of the NOL C/Fs for years 11 to 20 computed in Figure 3. Unlike Figure 4 where the NOL C/Fs utilization was computed on an annual basis, in Figure 5, we compute the present value as an annuity spread evenly over a

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[13] The historical percentages were computed in Figure 2 of this appendix and are based on data from academic paper *The Implication of Tax Asymmetry for U.S. Corporations by Michael Cooper and Matthew Knittel.*

[14] The historical percentages were computed in Figure 2 of this appendix and are based on data from academic paper *The Implication of Tax Asymmetry for U.S. Corporations by Michael Cooper and Matthew Knittel.*

[15] The numbers presented may be slightly off due to rounding.

10-year period. The annual NOL C/Fs used is computed by multiplying the tax value of NOL C/F used in years 11 to 20 (obtained in Figure 3) by 10 percent. The annual NOL C/Fs used is then multiplied by the PVIFA,$_{2.92\%,11\text{-}20}$ to obtain the present value.

Figure 5: Present Value Calculation of NOL Carryforwards Years 11 to 20

Description	Tax Value of NOL C/F Used in Years 11 to 20	Use Over 10 Years	Annual NOL C/Fs Utilized	PVIFA, $_{2.92\%,11\text{-}20}$	Present Value
Low Range Years 11 to 20	152,713,950,849	10%	15,271,395,085	6.42297823	98,087,838,172
High Range Years 11 to 20	114,535,463,137	10%	11,453,546,314	6.42297823	73,565,878,629

Source: TIGTA computation. Tax value of NOL C/Fs used in years 11 to 20 computed from Figure 3, assumed straight line usage of 10 percent NOL C/Fs used each year, and PVIFA, $_{2.92\%,11\text{-}20}$.

In Figure 6, we computed the stated tax value based on the assumptions and the low and high range of the estimated cost (present value) of the PY 2012 NOL carryforwards by summing present values of NOL C/Fs not used from Figure 3 (because they expire unused, they have no present value), NOL C/Fs used in years one to 10 from Figure 4, and NOL C/Fs used in years 11 to 20 from Figure 5. The sum results in a low range estimate of the present value of about $371 billion and a high range estimate of about $414 billion with a stated tax value of $687 billion. That means the Department of the Treasury will pay between 54 cents ($371 billion/$687 billion) and 60 cents ($414 billion/$687 billion) on the stated tax value of NOL carryforwards or between 19 cents ($371 billion/$1.963 trillion) and 21 cents ($414 billion/$1.963 trillion) for each dollars of NOL carryforward in reduced taxes.

Figure 6: Estimated Cost of PY 2012 NOL Carryforwards

	Low Range		High Range	
Description	Tax Value	Present Value	Tax Value	Present Value
NOL C/Fs Not Used (Expired)	$229,070,926,274	$0	$190,892,438,561	$0
NOL C/Fs Used in Years 1 to 10	305,427,901,698	272,801,787,811	381,784,877,123	340,162,308,034
NOL C/Fs Used in Years 11 to 20	152,713,950,849	98,087,838,172	114,535,463,137	73,565,878,629
Total	$687,212,778,821	$370,889,625,983	$687,212,778,821	$413,728,186,663

Source: TIGTA computation. Tax value information from Figure 3, present value information for NOL C/Fs used in years one to 10 from Figure 4, and present value information for NOL C/Fs used in years 11 to 20 from Figure 5.

Economists with the Department of the Treasury's Office of Tax Policy agreed with our methodology after recommending changes that we incorporated. While the Office of Tax Policy agreed with our methodology, it expressed no opinion regarding our final results. With respect to our final result, TIGTA believes this is an informative estimate that illustrates the cost to the Federal Government of the corporate NOL carryforwards at a given point in time, based on a set of assumptions and the best available data we had access to. As we described in our assumptions, changes in technology, the business cycle, the weather, and other things could affect our estimate positively or negatively.

Appendix V

Form 1120X, Amended U.S. Corporation Income Tax Return

Form **1120X**
(Rev. January 2011)
Department of the Treasury
Internal Revenue Service

Amended U.S. Corporation Income Tax Return

OMB No. 1545-0132
For tax year ending
▶
(Enter month and year.)

Please Type or Print		
	Name	Employer identification number
	Number, street, and room or suite no. (If a P.O. box, see instructions.)	
	City or town, state, and ZIP code	Telephone number (optional)

Enter name and address used on original return (If same as above, write "Same.")

Internal Revenue Service Center where original return was filed ▶

Fill in applicable items and use Part II on the back to explain any changes

Part I **Income and Deductions** (see instructions)		(a) As originally reported or as previously adjusted	(b) Net change — increase or (decrease) — explain in Part II	(c) Correct amount
1 Total income	1			
2 Total deductions	2			
3 Taxable income. Subtract line 2 from line 1	3			
4 Total tax	4			
Payments and Credits (see instructions)				
5a Overpayment in prior year allowed as a credit	5a			
b Estimated tax payments	5b			
c Refund applied for on Form 4466	5c			
d Subtract line 5c from the sum of lines 5a and 5b	5d			
e Tax deposited with Form 7004	5e			
f Credit from Form 2439	5f			
g Credit for federal tax on fuels and other refundable credits	5g			
6 Tax deposited or paid with (or after) the filing of the original return			6	
7 Add lines 5d through 6, column (c)			7	
8 Overpayment, if any, as shown on original return or as later adjusted			8	
9 Subtract line 8 from line 7			9	
Tax Due or Overpayment (see instructions)				
10 **Tax due.** Subtract line 9 from line 4, column (c). If paying by check, make it payable to the **"United States Treasury"** ▶			10	
11 **Overpayment.** Subtract line 4, column (c), from line 9 ▶			11	
12 Enter the amount of line 11 you want: **Credited to 20** **Estimated tax** ▶ **Refunded** ▶			12	

Sign Here

Under penalties of perjury, I declare that I have filed an original return and that I have examined this amended return, including accompanying schedules and statements, and to the best of my knowledge and belief, this amended return is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Signature of officer | Date | ▶ Title

Paid Preparer Use Only				
Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

For Paperwork Reduction Act Notice, see instructions. Cat. No. 11530Z Form **1120X** (Rev. 1-2011)

Form 1120X (Rev. 1-2011) Page **2**

Part II **Explanation of Changes to Items in Part I** (Enter the line number from page 1 for the items you are changing, and give the reason for each change. Show any computation in detail. Also, see **What To Attach** in the instructions.)

If the change is due to a net operating loss carryback, a capital loss carryback, or a general business credit carryback, see **Carryback Claims** in the instructions, and check here . . . . ▶ ☐

Form **1120X** (Rev. 1-2011)

Source: Internal Revenue Service.

Appendix VI

Form 1139, Corporation Application for Tentative Refund

Form **1139** (Rev. December 2012) Department of the Treasury Internal Revenue Service

Corporation Application for Tentative Refund

► Information about Form 1139 and its separate instructions is at *www.irs.gov/form1139.*
► Do not file with the corporation's income tax return—file separately.
► Keep a copy of this application for your records.

OMB No. 1545-0582

Name	Employer identification number
Number, street, and room or suite no. If a P.O. box, see instructions.	Date of incorporation
City or town, state, and ZIP code	Daytime phone number

1 Reason(s) for filing. See instructions—attach computation: a Net operating loss (NOL) ► $; b Net capital loss ► $; c Unused general business credit ► $; d Other ► $

2 Return for year of loss, unused credit, or overpayment under section 1341(b)(1) ► a Tax year ended; b Date tax return filed; c Service center where filed

3 If this application is for an unused credit created by another carryback, enter ending date for the tax year of the first carryback ►

4 Did a loss result in the release of a foreign tax credit, or is the corporation carrying back a general business credit that was released because of the release of a foreign tax credit (see instructions)? If "Yes," the corporation must file an amended return to carry back the released credits . . . ☐ Yes ☐ No

5a Was a consolidated return filed for any carryback year or did the corporation join a consolidated group (see instructions)? ☐ Yes ☐ No

b If "Yes," enter the tax year ending date and the name of the common parent and its EIN, if different from above (see instructions) ►

6a If Form 1138 has been filed, was an extension of time granted for filing the return for the tax year of the NOL? ☐ Yes ☐ No

b If "Yes," enter the date to which extension was granted ► c Enter the date Form 1138 was filed . ►

d Unpaid tax for which Form 1138 is in effect . . . ► $

7 If the corporation changed its accounting period, enter the date permission to change was granted . . . ►

8 If this is an application for a dissolved corporation, enter date of dissolution . . . ►

9 Has the corporation filed a petition in Tax Court for the year or years to which the carryback is to be applied? ☐ Yes ☐ No

10 Is any part of the decrease in tax due to a loss or credit resulting from a reportable transaction required to be disclosed? If Yes, attach Form 8886 . . . ☐ Yes ☐ No

Computation of Decrease in Tax See instructions. **Note:** *If only filing for an unused general business credit (line 1c), skip lines 11 through 15.*	____ preceding tax year ended ► ____ (a) Before carryback	(b) After carryback	____ preceding tax year ended ► ____ (c) Before carryback	(d) After carryback	____ preceding tax year ended ► ____ (e) Before carryback	(f) After carryback
11 Taxable income from tax return						
12 **Capital loss carryback (see instructions)**						
13 Subtract line 12 from line 11						
14 **NOL deduction (see instructions)**						
15 Taxable income. Subtract line 14 from line 13						
16 **Income tax**						
17 Alternative minimum tax						
18 Add lines 16 and 17						
19 General business credit (see instructions)						
20 Other credits (see instructions)						
21 Total credits. Add lines 19 and 20						
22 Subtract line 21 from line 18						
23 Personal holding company tax (Sch. PH (Form 1120))						
24 Other taxes (see instructions)						
25 Total tax liability. Add lines 22 through 24						
26 Enter amount from "After carryback" column on line 25 for each year						
27 Decrease in tax. Subtract line 26 from line 25						
28 Overpayment of tax due to a claim of right adjustment under section 1341(b)(1) (attach computation)						

Sign Here Under penalties of perjury, I declare that I have examined this application and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete.
Signature of officer | Date | Title

Paid Preparer Use Only Print/Type preparer's name | Preparer's signature | Date | Check ☐ if self-employed | PTIN
Firm's name ► | Firm's EIN ►
Firm's address ► | Phone no.

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11170F Form **1139** (Rev. 12-2012)

Source: Internal Revenue Service.

Appendix VII

Form 1120, Schedule M-3, Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More

SCHEDULE M-3 (Form 1120)
Department of the Treasury
Internal Revenue Service

Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More

► Attach to Form 1120 or 1120-C. ► Information about Schedule M-3 (Form 1120) and its separate instructions is available at *www.irs.gov/form1120*.

OMB No. 1545-0123

2013

Name of corporation (common parent, if consolidated return) | Employer identification number

Check applicable box(es): (1) ☐ Non-consolidated return (2) ☐ Consolidated return (Form 1120 only)
(3) ☐ Mixed 1120/L/PC group (4) ☐ Dormant subsidiaries schedule attached

Part I Financial Information and Net Income (Loss) Reconciliation (see instructions)

1a Did the corporation file SEC Form 10-K for its income statement period ending with or within this tax year?
☐ **Yes.** Skip lines 1b and 1c and complete lines 2a through 11 with respect to that SEC Form 10-K.
☐ **No.** Go to line 1b. See instructions if multiple non-tax-basis income statements are prepared.
b Did the corporation prepare a certified audited non-tax-basis income statement for that period?
☐ **Yes.** Skip line 1c and complete lines 2a through 11 with respect to that income statement.
☐ **No.** Go to line 1c.
c Did the corporation prepare a non-tax-basis income statement for that period?
☐ **Yes.** Complete lines 2a through 11 with respect to that income statement.
☐ **No.** Skip lines 2a through 3c and enter the corporation's net income (loss) per its books and records on line 4a.
2a Enter the income statement period: Beginning MM/DD/YYYY Ending MM/DD/YYYY
b Has the corporation's income statement been restated for the income statement period on line 2a?
☐ **Yes.** (If "Yes," attach an explanation and the amount of each item restated.)
☐ **No.**
c Has the corporation's income statement been restated for any of the five income statement periods preceding the period on line 2a?
☐ **Yes.** (If "Yes," attach an explanation and the amount of each item restated.)
☐ **No.**
3a Is any of the corporation's voting common stock publicly traded?
☐ **Yes.**
☐ **No.** If "No," go to line 4a.
b Enter the symbol of the corporation's primary U.S. publicly traded voting common stock . . . . .
c Enter the nine-digit CUSIP number of the corporation's primary publicly traded voting common stock . . . . .

4a	Worldwide consolidated net income (loss) from income statement source identified in Part I, line 1	**4a**	
b	Indicate accounting standard used for line 4a (see instructions): (1) ☐ GAAP (2) ☐ IFRS (3) ☐ Statutory (4) ☐ Tax-basis (5) ☐ Other (specify)		
5a	Net income from nonincludible foreign entities (attach statement)	**5a**	( )
b	Net loss from nonincludible foreign entities (attach statement and enter as a positive amount)	**5b**	
6a	Net income from nonincludible U.S. entities (attach statement)	**6a**	( )
b	Net loss from nonincludible U.S. entities (attach statement and enter as a positive amount)	**6b**	
7a	Net income (loss) of other includible foreign disregarded entities (attach statement)	**7a**	
b	Net income (loss) of other includible U.S. disregarded entities (attach statement)	**7b**	
c	Net income (loss) of other includible entities (attach statement)	**7c**	
8	Adjustment to eliminations of transactions between includible entities and nonincludible entities (attach statement)	**8**	
9	Adjustment to reconcile income statement period to tax year (attach statement)	**9**	
10a	Intercompany dividend adjustments to reconcile to line 11 (attach statement)	**10a**	
b	Other statutory accounting adjustments to reconcile to line 11 (attach statement)	**10b**	
c	Other adjustments to reconcile to amount on line 11 (attach statement)	**10c**	
11	**Net income (loss) per income statement of includible corporations.** Combine lines 4 through 10	**11**	

Note. Part I, line 11, must equal the amount on Part II, line 30, column (a), and Schedule M-2, line 2.

12 Enter the total amount (not just the corporation's share) of the assets and liabilities of all entities included or removed on the following lines.

	Total Assets	Total Liabilities
a Included on Part I, line 4 ►		
b Removed on Part I, line 5 ►		
c Removed on Part I, line 6 ►		
d Included on Part I, line 7 ►		

For Paperwork Reduction Act Notice, see the Instructions for Form 1120. Cat. No. 37961C Schedule M-3 (Form 1120) 2013

Schedule M-3 (Form 1120) 2013 Page **2**

Name of corporation (common parent, if consolidated return) | Employer identification number

Check applicable box(es): (1) ☐ Consolidated group (2) ☐ Parent corp (3) ☐ Consolidated eliminations (4) ☐ Subsidiary corp (5) ☐ Mixed 1120/L/PC group

Check if a sub-consolidated: (6) ☐ 1120 group (7) ☐ 1120 eliminations

Name of subsidiary (if consolidated return) | Employer identification number

Part II **Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return** (see instructions)

Income (Loss) Items (Attach statements for lines 1 through 11)	(a) Income (Loss) per Income Statement	(b) Temporary Difference	(c) Permanent Difference	(d) Income (Loss) per Tax Return
1 Income (loss) from equity method foreign corporations				
2 Gross foreign dividends not previously taxed				
3 Subpart F, QEF, and similar income inclusions				
4 Section 78 gross-up				
5 Gross foreign distributions previously taxed				
6 Income (loss) from equity method U.S. corporations				
7 U.S. dividends not eliminated in tax consolidation				
8 Minority interest for includible corporations				
9 Income (loss) from U.S. partnerships				
10 Income (loss) from foreign partnerships				
11 Income (loss) from other pass-through entities				
12 Items relating to reportable transactions (attach statement)				
13 Interest income (attach Form 8916-A)				
14 Total accrual to cash adjustment				
15 Hedging transactions				
16 Mark-to-market income (loss)				
17 Cost of goods sold (attach Form 8916-A)	( )			( )
18 Sale versus lease (for sellers and/or lessors)				
19 Section 481(a) adjustments				
20 Unearned/deferred revenue				
21 Income recognition from long-term contracts				
22 Original issue discount and other imputed interest				
23a Income statement gain/loss on sale, exchange, abandonment, worthlessness, or other disposition of assets other than inventory and pass-through entities				
b Gross capital gains from Schedule D, excluding amounts from pass-through entities				
c Gross capital losses from Schedule D, excluding amounts from pass-through entities, abandonment losses, and worthless stock losses				
d Net gain/loss reported on Form 4797, line 17, excluding amounts from pass-through entities, abandonment losses, and worthless stock losses				
e Abandonment losses				
f Worthless stock losses (attach statement)				
g Other gain/loss on disposition of assets other than inventory				
24 Capital loss limitation and carryforward used				
25 Other income (loss) items with differences (attach statement)				
26 **Total income (loss) items.** Combine lines 1 through 25				
27 **Total expense/deduction items** (from Part III, line 38)				
28 Other items with no differences				
29a Mixed groups, see instructions. All others, combine lines 26 through 28				
b PC insurance subgroup reconciliation totals				
c Life insurance subgroup reconciliation totals				
30 **Reconciliation totals.** Combine lines 29a through 29c				

Note. Line 30, column (a), must equal the amount on Part I, line 11, and column (d) must equal Form 1120, page 1, line 28.

Schedule M-3 (Form 1120) 2013

Schedule M-3 (Form 1120) 2013 Page **3**

Name of corporation (common parent, if consolidated return) | Employer identification number

Check applicable box(es): (1) ☐ Consolidated group (2) ☐ Parent corp (3) ☐ Consolidated eliminations (4) ☐ Subsidiary corp (5) ☐ Mixed 1120/L/PC group

Check if a sub-consolidated: (6) ☐ 1120 group (7) ☐ 1120 eliminations

Name of subsidiary (if consolidated return) | Employer identification number

Part III **Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return—Expense/Deduction Items** (see instructions)

Expense/Deduction Items	(a) Expense per Income Statement	(b) Temporary Difference	(c) Permanent Difference	(d) Deduction per Tax Return
1 U.S. current income tax expense				
2 U.S. deferred income tax expense				
3 State and local current income tax expense				
4 State and local deferred income tax expense				
5 Foreign current income tax expense (other than foreign withholding taxes)				
6 Foreign deferred income tax expense				
7 Foreign withholding taxes				
8 Interest expense (attach Form 8916-A)				
9 Stock option expense				
10 Other equity-based compensation				
11 Meals and entertainment				
12 Fines and penalties				
13 Judgments, damages, awards, and similar costs				
14 Parachute payments				
15 Compensation with section 162(m) limitation				
16 Pension and profit-sharing				
17 Other post-retirement benefits				
18 Deferred compensation				
19 Charitable contribution of cash and tangible property				
20 Charitable contribution of intangible property				
21 Charitable contribution limitation/carryforward				
22 Domestic production activities deduction				
23 Current year acquisition or reorganization investment banking fees				
24 Current year acquisition or reorganization legal and accounting fees				
25 Current year acquisition/reorganization other costs				
26 Amortization/impairment of goodwill				
27 Amortization of acquisition, reorganization, and start-up costs				
28 Other amortization or impairment write-offs				
29 Reserved				
30 Depletion				
31 Depreciation				
32 Bad debt expense				
33 Corporate owned life insurance premiums				
34 Purchase versus lease (for purchasers and/or lessees)				
35 Research and development costs				
36 Section 118 exclusion (attach statement)				
37 Other expense/deduction items with differences (attach statement)				
38 **Total expense/deduction items.** Combine lines 1 through 37. Enter here and on Part II, line 27, reporting positive amounts as negative and negative amounts as positive				

Schedule M-3 (Form 1120) 2013

Source: Internal Revenue Service.

Appendix VIII

Form 1120, Schedule UTP, Uncertain Tax Position Statement

SCHEDULE UTP (Form 1120)

Department of the Treasury Internal Revenue Service

Uncertain Tax Position Statement

▶ File with Form 1120, 1120-F, 1120-L, or 1120-PC.

▶ Information about Schedule UTP (Form 1120) and its separate instructions is at *www.irs.gov/scheduleutp*.

OMB No. 1545-0123

2013

Name of entity as shown on page 1 of tax return | EIN of entity

This Part I, Schedule UTP (Form 1120) is page ______ of ______ Part I pages.

Part I **Uncertain Tax Positions for the Current Tax Year.** See instructions for how to complete columns (a) through (g). Enter, in Part III, a description for each uncertain tax position (UTP).

Check this box if the corporation was unable to obtain information from related parties sufficient to determine whether a tax position is a UTP (see instructions) ▶ ☐

(a) UTP No.	(b) Primary IRC Sections (e.g., "61", "108", "263A", etc.) / Primary IRC Subsections (e.g. (f)(2)(A)(ii))			(c) Timing Codes (check if Permanent, Temporary, or both)		(d) Pass-Through Entity EIN	(e) Major Tax Position	(f) Ranking of Tax Position	(g) Reserved for Future Use
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		
C	( )( )( )( )	( )( )( )( )	( )( )( )( )	P	T	-	☐		

For Paperwork Reduction Act Notice, see the Instructions for Form 1120. Cat. No. 54658Q Schedule UTP (Form 1120) 2013

Schedule UTP (Form 1120) 2013 Page **2**

Name of entity as shown on page 1 of tax return	EIN of entity

This Part II, Schedule UTP (Form 1120) is page ______ of ______ Part II pages.

Part II **Uncertain Tax Positions for Prior Tax Years.**

See instructions for how to complete columns (a) through (h). Enter, in Part III, a description for each uncertain tax position (UTP).

Check this box if the corporation was unable to obtain information from related parties sufficient to determine whether a tax position is a UTP (see instructions) ▶ ☐

(a) UTP No.	(b) Primary IRC Sections (e.g., "61", "108", "263A", etc.) / Primary IRC Subsections (e.g. (f)(2)(A)(ii))	(c) Timing Codes (check if Permanent, Temporary, or both)	(d) Pass-Through Entity EIN	(e) Major Tax Position	(f) Ranking of Tax Position	(g) Reserved for Future Use	(h) Year of Tax Position
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			
P	( )( )( )( ) ( )( )( )( ) ( )( )( )( )	P T	-	☐			

Schedule UTP (Form 1120) 2013

Schedule UTP (Form 1120) 2013 Page 3

Name of entity as shown on page 1 of tax return	EIN of entity

This Part III, Schedule UTP (Form 1120) is page ______ of ______ Part III pages.

Part III **Concise Descriptions of UTPs.** Indicate the corresponding UTP number from Part I, column (a) (e.g. C1) or Part II column (a) (e.g. P2). Use as many Part III pages as necessary (see instructions).

UTP No.	Concise Description of Uncertain Tax Position

Schedule UTP (Form 1120) 2013

Source: Internal Revenue Service.

Appendix IX

Form 8886, Reportable Transaction Disclosure Statement

Form **8886** (Rev. March 2011) Department of the Treasury Internal Revenue Service

Reportable Transaction Disclosure Statement

▶ **Attach to your tax return.**
▶ **See separate instructions.**

OMB No. 1545-1800
Attachment Sequence No. 137

Name(s) shown on return (individuals enter last name, first name, middle initial)			**Identifying number**
Number, street, and room or suite no.	City or town	State	ZIP code

A If you are filing more than one Form 8886 with your tax return, sequentially number each Form 8886 and enter the statement number for this Form 8886 . . . . ▶ Statement number ______ of ______

B Enter the form number of the tax return to which this form is attached or related . . . . ▶ ______
Enter the year of the tax return identified above . . . . ▶ ______
Is this Form 8886 being filed with an amended tax return? . . . . ▶ ☐ Yes ☐ No

C Check the box(es) that apply (see instructions). ☐ Initial year filer ☐ Protective disclosure

1a Name of reportable transaction

1b Initial year participated in transaction | **1c** Reportable transaction or tax shelter registration number (see instructions)

2 Identify the type of reportable transaction. Check all boxes that apply (see instructions).
a ☐ Listed **c** ☐ Contractual protection **e** ☐ Transaction of interest
b ☐ Confidential **d** ☐ Loss

3 If you checked box 2a or 2e, enter the published guidance number for the listed transaction or transaction of interest . . . . ▶ ______

4 Enter the number of "same as or substantially similar" transactions reported on this form . . . . ▶ ______

5 If you participated in this reportable transaction through a partnership, S corporation, trust, and foreign entity, check the applicable boxes and provide the information below for the entity(s) (see instructions). (Attach additional sheets, if necessary.)

a Type of entity . . . . ▶	☐ Partnership ☐ Trust ☐ S corporation ☐ Foreign	☐ Partnership ☐ Trust ☐ S corporation ☐ Foreign
b Name . . . . ▶		
c Employer identification number (EIN), if known . . . . ▶		
d Date Schedule K-1 received from entity (enter "none" if Schedule K-1 not received) . . . . ▶		

6 Enter below the name and address of each individual or entity to whom you paid a fee with regard to the transaction if that individual or entity promoted, solicited, or recommended your participation in the transaction, or provided tax advice related to the transaction. (Attach additional sheets, if necessary.)

a Name		Identifying number (if known)	Fees paid $
Number, street, and room or suite no.	City or town	State	ZIP code
b Name		Identifying number (if known)	Fees paid $
Number, street, and room or suite no.	City or town	State	ZIP code

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 34654G Form **8886** (Rev. 3-2011)

Form 8886 (Rev. 3-2011) Page **2**

7 Facts

a Identify the type of tax benefit generated by the transaction. Check all the boxes that apply (see instructions).

☐ Deductions ☐ Exclusions from gross income ☐ Absence of adjustments to basis ☐ Tax Credits
☐ Capital loss ☐ Nonrecognition of gain ☐ Deferral
☐ Ordinary loss ☐ Adjustments to basis ☐ Other ______________________

b Further describe the amount and nature of the expected tax treatment and expected tax benefits generated by the transaction for all affected years. Include facts of each step of the transaction that relate to the expected tax benefits including the amount and nature of your investment. Include in your description your participation in the transaction and all related transactions regardless of the year in which they were entered into. Also, include a description of any tax result protection with respect to the transaction.

8 Identify all individuals and entities involved in the transaction that are tax-exempt, foreign, or related. Check the appropriate box(es) (see instructions). Include their name(s), identifying number(s), address(es), and a brief description of their involvement. For each foreign entity, identify its country of incorporation or existence. For each individual or related entity, explain how the individual or entity is related. Attach additional sheets, if necessary.

a Type of individual or entity: ☐ Tax-exempt ☐ Foreign ☐ Related

Name	Identifying number
Address	
Description	

b Type of individual or entity: ☐ Tax-exempt ☐ Foreign ☐ Related

Name	Identifying number
Address	
Description	

Form **8886** (Rev. 3-2011)

Source: Internal Revenue Service.

Form 8886, *Reportable Transaction Disclosure Statement*, is used to disclose information for each reportable transaction and generally a separate Form 8886 is required for each reportable transaction. However, one form may be used for transactions that are the same or substantially similar. A reportable transaction is a transaction described in one or more of the following categories:

- A **listed transaction** is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction.[1]
- A **confidential transaction** is a transaction that is offered to a corporation or a related party under conditions of confidentiality and for which a corporation or a related party paid an advisor a minimum fee of $250,000.
- A **transaction with contractual protection** is a transaction for which the corporation has, or a related party has, the right to a full refund or partial refund of fees if all or part of the intended tax consequences from the transaction is not sustained.
- A **loss transaction** is a transaction that results in the corporation claiming a loss under I.R.C. Section 165 if the amount of the I.R.C. Section 165 loss for a corporation (excluding S corporations) is at least $10 million in any single tax year or $20 million in any combination of tax years.
- A **transaction of interest** is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest. It is a transaction that the IRS and Department of the Treasury believe has a potential for tax avoidance or evasion, but for which there is not enough information to determine if the transaction should be identified as a tax avoidance transaction.

Corporate taxpayers required to file Form 8886 must attach it to their income tax return, including amended returns, for each tax year in which they participated in a reportable transaction. Form 8886 must also be attached to Form 1139, *Corporation Application for Tentative Refund*, if a reportable transaction results in a loss or credit carried back to a prior year. Also, if this is an initial year of filing Form 8886 for a transaction, an exact duplicate must be filed with the OTSA in Ogden, Utah.

Failure to file Form 8886 can have serious repercussions for a corporation:

1. Failure by a corporation to disclose a listed transaction will result in the period to assess any tax with respect to the listed transaction being extended beyond the normal three-year assessment period until one year after the earlier of either:

[1] These transactions are identified by notice, regulation, or other forms of published guidance as a listed transaction.

- The date the corporation discloses the transaction by filing Form 8886 in the manner prescribed, or
- The date that a material advisor provides the information required (investor list) under I.R.C. Section 6112 in response to a request by the IRS under I.R.C. Section 6112.

2. Generally, the penalty for failure to include information with respect to a reportable transaction for a corporation taxpayer is 75 percent of the reduction in the tax reported on the income tax return as a result of participation in the transaction or that would result if the transaction were respected for Federal tax purposes, but not less than $10,000. The maximum annual penalty for failure to disclose a reportable transaction, other than a listed transaction, cannot exceed $50,000. The maximum annual penalty for failure to include information with respect to a listed transaction is $200,000.

Each Form 8886 disclosure received by the OTSA at the Ogden Campus is reviewed by an analyst for completeness and to determine which disclosures have large, unusual, or questionable items or listed transactions requiring further action or review. Each disclosure is then assigned a specific tax shelter-type identification number. The disclosures and any supporting documents are then scanned and saved into a repository. Data from certain fields on the disclosure are then transcribed into a database for further review. Additional data from the associated tax return and the AIMS, such as the business operating division Examination Status Code and Examination Group Code, are added to the database for disclosure requiring further action. These disclosures are then re-sorted by the business operation division and disseminated.

For LB&I Division disclosures, if the associated return is under examination, the OTSA analyst notifies the team manager controlling the return of the disclosure and requests a review of the transaction. If the associated return is not currently under examination, the OTSA analyst sends the disclosure to the appropriate workload identification team for further risk assessment and possible assignment to an examination team. If the OTSA has identified the disclosure as potentially incomplete, the notification will also request consideration of a potential penalty under I.R.C. Section 6707A. For disclosures with associated returns in other business units, the OTSA makes available its database and the disclosures to the other business units to aid further review and assist the other units in determining whether to examine the return.

Besides the disclosures required of the corporate taxpayer, the IRS also requires material advisors to any reportable transaction to disclose certain information about the transaction on Form 8918, *Material Advisor Disclosure Statement* (see Appendix X). A reportable transaction has the same definition as previously described for Form 8886. A material advisor can be an individual, trust, estate, partnership, or corporation. A material advisor is anyone who:

- Provides any material aid, assistance, or advice with respect to the organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction; and

- Directly or indirectly receives or expects to receive gross income in excess of the threshold amount, $250,000, or in the case of a listed transaction $25,000, for the material aid, assistance, or advice.

The material advisor's disclosure statement must be filed with the OTSA in Ogden, Utah by the last day of the month that follows the end of the calendar quarter in which the advisor became a material advisor with respect to the reportable transaction or in which circumstances occur to require an amended disclosure statement. Failure to file Form 8918 on or before the due date or filing false or incomplete information about a reportable transaction can result in a penalty of $50,000 for reportable transactions other than listed transactions. The penalty for a listed transaction is the greater of:

- $200,000; or
- 50 percent of the gross income from providing aid, assistance, or advice about the listed transaction before the date the return is filed. If the failure is intentional, the percentage is 75 percent.

Material advisors who file a Form 8918 will receive a reportable transaction number from the IRS. Material advisors must provide the reportable transaction number to all taxpayers and material advisors for whom the material advisor acts as a material advisor.

Appendix X

Form 8918, Material Advisor Disclosure Statement

Form **8918**
(Rev. December 2011)
Department of the Treasury
Internal Revenue Service

Material Advisor Disclosure Statement

► **See separate instructions.**

OMB No. 1545-0865

FOR IRS USE ONLY

Note. The reportable transaction number will be sent to the material advisor's address below.

Material Advisor's Name (see instructions)	Identifying number	Telephone number
Number, street, and room or suite no.		
City or town, state, and ZIP code		

A Contact person name (last name, first name, middle initial)	Title	Telephone number

B Is this a protective disclosure? (see instructions) ☐ Yes ☐ No If "Yes," see line 6a instructions.

C Is this the original Form 8918 for this reportable transaction? ☐ Yes ☐ No

If "Yes," go to line 1. If "No," enter the reportable transaction number previously issued for this reportable transaction or tax shelter.

Reportable Transaction Number ►

1 Name of reportable transaction (see instructions)

2 Identify the type of reportable transaction. Check all the box(es) that apply (see instructions).

a ☐ Listed **c** ☐ Contractual protection **e** ☐ Transaction of interest

b ☐ Confidential **d** ☐ Loss

3 If you checked box 2a or 2e, enter the published guidance number for the listed transaction or transaction of interest ►

4 Enter the date the Material Advisor became a material advisor with respect to the reportable transaction (see instructions) ►

5 If you are a party to a designation agreement, identify the other parties (see instructions).

Name	Identifying number (if known)
Address (Number, street, and room or suite no.)	
City or town, state, and ZIP code	
Contact name	Telephone number

6a Provide a brief description of the type of material aid, assistance, or advice you provided (see instructions).

b Describe the role of any other entity(ies) or individual(s) who you know or have reason to know provided material aid, assistance, or advice to this transaction and include each entity's and individual's complete name, identifying number (if known), and address.

7a To obtain the intended tax benefits generated by the transaction:

Is a related entity(ies) or individual(s) needed? ☐ Yes ☐ No

Is a foreign entity(ies) or individual(s) needed? ☐ Yes ☐ No

Is a tax-exempt entity(ies) needed? ☐ Yes ☐ No

b If you answered "Yes" to any of the above questions, describe the role of each individual or entity. Also identify the individual's or entity's country of existence if a particular country is required to obtain the intended tax benefits.

8a To obtain the intended tax benefits generated by the transaction, is income or gain from the transaction allocated directly or indirectly to an individual(s) or entity(ies) that has a net operating loss and/or unused loss or credits? ☐ Yes ☐ No

b If "Yes," describe the role of each individual or entity in the transaction.

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 39533A Form **8918** (Rev. 12-2011)

Form 8918 (Rev. 12-2011) Page **2**

9 Identify the types of financial instruments used in this transaction (see instructions).

10 Estimated Tax Benefits—Identify the type of tax benefit generated by the transaction that you expect the taxpayer to claim in each year. Check all boxes that apply (see instructions).

☐ Deductions ☐ Exclusions from gross income ☐ Tax credits ☐ Other
☐ Capital loss ☐ Nonrecognition of gain ☐ Deferral
☐ Ordinary loss ☐ Adjustments to basis ☐ Absence of adjustments to basis

11 Timing of Tax Benefits—If you checked one or more boxes on line 10, check the applicable box(es) below to identify the period in which such tax benefits are claimed. Check each box that applies.

☐ Tax benefits generated by the transaction are required to be claimed in the first year of participation by the taxpayer.
☐ Tax benefits may be claimed in another year by the taxpayer.

12 Enter the Internal Revenue Code section(s) used to claim tax benefit(s) generated by the transaction. (Attach additional sheets if necessary.)

13 Describe the reportable transaction for which you provided material aid, assistance or advice, including but not limited to the following: the nature of the expected tax treatment and expected tax benefits generated by the transaction for all affected years, the years the tax benefits are expected to be claimed, the role of the entities or individuals mentioned in lines 7a or 8a (if any) and the role of the financial instruments mentioned in line 9 (if any). Explain how the Internal Revenue Code sections listed in line 12 are applied and how they allow the taxpayer to obtain the desired tax treatment. Also, include a description of any tax result protection with respect to the transaction.

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature of Material Advisor Date Title

Print name

Form **8918** (Rev. 12-2011)

Source: Internal Revenue Service.

Appendix XI

Form 8275, Disclosure Statement

Form **8275** (Rev. August 2008) Department of the Treasury Internal Revenue Service

Disclosure Statement

Do not use this form to disclose items or positions that are contrary to Treasury regulations. Instead, use Form 8275-R, Regulation Disclosure Statement. See separate instructions.

▶ Attach to your tax return.

OMB No. 1545-0889

Attachment Sequence No. **92**

Name(s) shown on return | Identifying number shown on return

Part I **General Information** (see instructions)

	(a) Rev. Rul., Rev. Proc., etc.	(b) Item or Group of Items	(c) Detailed Description of Items	(d) Form or Schedule	(e) Line No.	(f) Amount
1						
2						
3						
4						
5						
6						

Part II **Detailed Explanation** (see instructions)

1

2

3

4

5

6

Part III **Information About Pass-Through Entity.** To be completed by partners, shareholders, beneficiaries, or residual interest holders.

Complete this part only if you are making adequate disclosure for a pass-through item.

Note: *A pass-through entity is a partnership, S corporation, estate, trust, regulated investment company (RIC), real estate investment trust (REIT), or real estate mortgage investment conduit (REMIC).*

1 Name, address, and ZIP code of pass-through entity

2 Identifying number of pass-through entity

3 Tax year of pass-through entity / / to / /

4 Internal Revenue Service Center where the pass-through entity filed its return

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 61935M Form **8275** (Rev. 8-2008)

Form 8275 (Rev. 8-2008) Page 2

Part IV **Explanations** *(continued from Parts I and/or II)*

Form **8275** (Rev. 8-2008)

Source: Internal Revenue Service.

Appendix XII

Form 8275-R, Regulation Disclosure Statement

Form **8275-R**
(Rev. August 2008)
Department of the Treasury
Internal Revenue Service

Regulation Disclosure Statement

Use this form only to disclose items or positions that are contrary to Treasury regulations. For other disclosures, use Form 8275, Disclosure Statement.
See separate instructions.
► Attach to your tax return.

OMB No. 1545-0889
Attachment Sequence No. 92A

Name(s) shown on return | Identifying number shown on return

Part I **General Information** (see instructions)

(a) Regulation Section	(b) Item or Group of Items	(c) Detailed Description of Items	(d) Form or Schedule	(e) Line No.	(f) Amount
1					
2					
3					
4					
5					
6					

Part II **Detailed Explanation** (see instructions)

1

2

3

4

5

6

Part III **Information About Pass-Through Entity.** To be completed by partners, shareholders, beneficiaries, or residual interest holders.

Complete this part only if you are making adequate disclosure for a pass-through item.

Note: *A pass-through entity is a partnership, S corporation, estate, trust, regulated investment company (RIC), real estate investment trust (REIT), or real estate mortgage investment conduit (REMIC).*

1 Name, address, and ZIP code of pass-through entity

2 Identifying number of pass-through entity

3 Tax year of pass-through entity
/ / to / /

4 Internal Revenue Service Center where the pass-through entity filed its return

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 14594X Form **8275-R** (Rev. 8-2008)

Form 8275-R (Rev. 8-2008) Page 2

Part IV **Explanations** *(continued from Parts I and/or II)*

Form **8275-R** (Rev. 8-2008)

Source: Internal Revenue Service.

Appendix XIII

Form 4626, Alternative Minimum Tax—Corporations

Form **4626**

Department of the Treasury
Internal Revenue Service

Alternative Minimum Tax—Corporations

► Attach to the corporation's tax return.
► Information about Form 4626 and its separate instructions is at *www.irs.gov/form4626.*

OMB No. 1545-0175

2013

Name | Employer identification number

Note: *See the instructions to find out if the corporation is a small corporation exempt from the alternative minimum tax (AMT) under section 55(e).*

1	Taxable income or (loss) before net operating loss deduction	1	
2	**Adjustments and preferences:**		
a	Depreciation of post-1986 property	2a	
b	Amortization of certified pollution control facilities	2b	
c	Amortization of mining exploration and development costs	2c	
d	Amortization of circulation expenditures (personal holding companies only)	2d	
e	Adjusted gain or loss	2e	
f	Long-term contracts	2f	
g	Merchant marine capital construction funds	2g	
h	Section 833(b) deduction (Blue Cross, Blue Shield, and similar type organizations only)	2h	
i	Tax shelter farm activities (personal service corporations only)	2i	
j	Passive activities (closely held corporations and personal service corporations only)	2j	
k	Loss limitations	2k	
l	Depletion	2l	
m	Tax-exempt interest income from specified private activity bonds	2m	
n	Intangible drilling costs	2n	
o	Other adjustments and preferences	2o	
3	Pre-adjustment alternative minimum taxable income (AMTI). Combine lines 1 through 2o	3	
4	**Adjusted current earnings (ACE) adjustment:**		
a	ACE from line 10 of the ACE worksheet in the instructions — 4a		
b	Subtract line 3 from line 4a. If line 3 exceeds line 4a, enter the difference as a negative amount (see instructions) — 4b		
c	Multiply line 4b by 75% (.75). Enter the result as a positive amount — 4c		
d	Enter the excess, if any, of the corporation's total increases in AMTI from prior year ACE adjustments over its total reductions in AMTI from prior year ACE adjustments (see instructions). **Note:** *You **must** enter an amount on line 4d (even if line 4b is positive).* — 4d		
e	ACE adjustment. • If line 4b is zero or more, enter the amount from line 4c • If line 4b is less than zero, enter the **smaller** of line 4c or line 4d as a negative amount	4e	
5	Combine lines 3 and 4e. If zero or less, stop here; the corporation does not owe any AMT	5	
6	Alternative tax net operating loss deduction (see instructions)	6	
7	**Alternative minimum taxable income.** Subtract line 6 from line 5. If the corporation held a residual interest in a REMIC, see instructions	7	
8	**Exemption phase-out** (if line 7 is $310,000 or more, skip lines 8a and 8b and enter -0- on line 8c):		
a	Subtract $150,000 from line 7 (if completing this line for a member of a controlled group, see instructions). If zero or less, enter -0- — 8a		
b	Multiply line 8a by 25% (.25) — 8b		
c	Exemption. Subtract line 8b from $40,000 (if completing this line for a member of a controlled group, see instructions). If zero or less, enter -0-	8c	
9	Subtract line 8c from line 7. If zero or less, enter -0-	9	
10	Multiply line 9 by 20% (.20)	10	
11	Alternative minimum tax foreign tax credit (AMTFTC) (see instructions)	11	
12	Tentative minimum tax. Subtract line 11 from line 10	12	
13	Regular tax liability before applying all credits except the foreign tax credit	13	
14	**Alternative minimum tax.** Subtract line 13 from line 12. If zero or less, enter -0-. Enter here and on Form 1120, Schedule J, line 3, or the appropriate line of the corporation's income tax return	14	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 12955I Form **4626** (2013)

Source: Internal Revenue Service.

Appendix XIV

The Alternative Minimum Tax and Net Operating Losses

The AMT affects the NOL in two ways. For AMT purposes, an Alternative Tax Net Operating Loss Deduction (ATNOLD) is allowed instead of the regular tax NOLD. In general, the ATNOLD is the same as the NOLD except that:

1. The amount of the ATNOLD is limited to 90 percent of the Alternative Minimum Taxable Income (AMTI) determined without regard to the ATNOLD and the I.R.C. Section 199 production activities deduction. But the 90 percent of AMTI limitation does not apply to carrybacks and carryforwards of: Tax Years 2001 and 2002 NOLs, qualified disaster losses, or qualified GO Zone losses which can offset 100 percent of the AMTI; and

2. The ATNOLD is determined with the AMT adjustments and reduced by the AMT preferences.

The AMT also creates additional recordkeeping for taxpayers. Certain items of income, deductions, credits, and tax preferences receive different tax treatment for the AMT than for the regular tax as previously noted. Therefore, the corporation should maintain adequate records to support items refigured for the AMT. For example:

- Tax forms used for regular tax purposes that are completed a second time to refigure items of income, deductions, *etc.*, for the AMT;

- The computation of a carryback or carryforward to other tax years of certain deductions or credits (for example, net operating loss, capital loss, and foreign tax credit) if the AMT amount is different from the regular tax amount;

- The computation of a carryforward of a passive loss or tax shelter farm activity loss if the AMT amount is different from the regular tax amount; and

- "Running balance" of the excess of the corporation's total increases in the AMTI from the prior year, adjusted current earnings, adjustments over the total reductions in the AMTI from the prior year, and adjusted current earnings adjustments.

Figure 1: Computation of the Corporation AMT

	1. Taxable income or (loss) before the NOLD
Plus or Minus:	2. Adjustments and preferences[1]
Equals:	3. Pre-adjustment AMT income
Plus:	4. Adjusted current earnings adjustment
Equals:	5. Post adjustment AMT income
Less:	6. ATNOLD[2]
Equals:	7. AMTI
Less:	8. AMT Exemption
Equals:	9. AMTI after AMT Exemption
Multiply by 20 percent:	10. Tentative minimum tax before AMT Foreign Tax Credit
Less:	11. AMT Foreign Tax Credit
Equals:	12. Tentative minimum tax.
Less:	13. Regular tax liability (Form 1120, Schedule J, Line 2)
Equals:	14. AMT (if zero or less enter zero).

Source: IRS Form 4626, Alternative Minimum Tax—Corporations.

[1] AMT adjustments differ from preferences. Adjustments involve a substitution of AMT treatment of an item for the regular tax treatment. A preference involves the addition of the difference between the AMT treatment and the regular tax treatment. Some but not all adjustments can be negative amounts. Tax preferences cannot be negative amounts. Corporate AMT adjustments and preferences include: depreciation of post-1986 property; amortization of certified pollution control facilities; amortization of mining exploration and development costs; amortization of circulation expenditures; adjusted gain or loss; long-term contracts; merchant marine capital construction funds; Section 833(b) deduction; tax shelter farm activities; passive activities; loss limitations; depletion; tax-exempt interest income from specified private activity bonds; intangible drilling costs; income eligible for the American Samoa economic development credit; income from the biofuel producer, biodiesel, and renewable diesel fuels credits; income as the beneficiary of an estate or trust; net AMT adjustment from an electing large partnership; patron's AMT adjustment; cooperative's AMT adjustment; domestic production activities deduction; installment sales; and accelerated depreciation of real property and certain leased personal property (pre-1987).
[2] The amount of the ATNOLD is generally limited to 90 percent of the AMTI determined without regard to the ATNOLD.

Appendix XV

Method Used to Estimate Corporation Examination Coverage of Net Operating Loss and Non-Net Operating Loss Returns

To estimate the corporation examination coverage of NOL and non-NOL returns, we defined net income/loss as line 28 of the Form 1120, *U.S. Corporation Income Tax Return*, minus the dividend-received deduction. This measure reflects income minus deductions available to the firm before any losses are applied from the previous years. For multinational corporations, this measure of income includes any foreign income or loss.

We obtained the BRTF for PY 2007 to 2012 using the definition of net income previously discussed and created an indicator NOL_Rtn that we attached to each return record equal to one when net income was less than zero, indicating the existence of an NOL, or zero when net income was zero or positive. We then matched the BRTF information for PYs 2007 to 2012 using Taxpayer Identification Number, Master File Transaction code, and Tax Period to the closed Corporation AIMS for FYs 2010 to 2012 to append the NOL indicator on to the examination records.

The result of the match segmented the close corporation return examinations into three segments for each fiscal year as shown in the example for FY 2011 in Figure 1. These segments were NOL Returns Examined, Non-NOL Returns Examined, and Returns Examined in which NOL Status is Unknown. The Returns Examined in which NOL Status is Unknown consists primarily of returns closed that were in the examination stream prior to PY 2007, essentially returns filed for Tax Year 2005 and prior. The Returns Examined in which NOL Status is Unknown also consists of a number of duplicate filed returns from PYs 2007 to 2012 (Tax Years 2006 and later) in which NOL treatment was inconsistent. For example, one return filed would have an NOL whereas the duplicate would have no NOL or vice versa.

Figure 1: Corporation Returns Examined for FY 2011 After BRTF Data Match

Description	AIMS Activity Code	Returns Examined	Identified NOL Returns Examined	Identified Non-NOL Returns Examined	Returns Examined NOL Status Unknown
A	B	C	D	E	F
No Balance Sheet	203	1,930	368	870	692
Under $250,000	209	8,414	1,510	6,099	805
Subtotal		10,344	1,878	6,969	1,497
$250,000 to < $1 million	213	5,363	575	4,346	442
$1 million to < $5 million	215	3,169	388	2,497	284
$5 million to < $10 million	217	762	159	486	117
$10 million to < $50 million	219	4,049	651	3,073	325
$50 million to < $100 million	221	1,441	418	831	192
$100 million to < $250 million	223	1,287	329	653	305
$250 million to < $500 million	226	796	165	397	234
$500 million to < $1 billion	227	681	109	338	234
$1 billion to < $5 billion	228	1,191	143	566	482
$5 billion to < $20 billion	229	570	38	259	273
$20 billion or more	230	430	17	169	244
Total		30,083	4,870	20,584	4,629

Source: TIGTA computer analysis of the AIMS for FY 2011 matched to the BRTF for PY 2007 to 2012.

To permit us to compute the examination coverage rates of NOL and non-NOL returns, we were required to allocate the Returns Examined in which NOL Status was Unknown. Therefore, we assumed that the Unknown return examinations would have the same ratio of NOL and non-NOL return examinations as the known return examinations in each asset class and allocated them accordingly as shown in Figure 2.

Figure 2: Allocation of Returns Examined With Unknown Status to NOL and Non-NOL Returns

Description Asset Class	Identified NOL Returns Examined	Returns Examined NOL Status Known	Allocation Ratio	Returns Examined NOL Status Unknown	Allocation to NOL Examined Returns	Allocation to Non-NOL Examined Returns
From Figure 1	Col. D	Col. D + E		Col. F		
A	B	C	D = B/C	E	F = D × E	G = E - F
No Balance Sheet	368	1,238	0.297254	692	205	487
Under $250,000	1,510	7,609	0.198449	805	159	646
Subtotal	1,878	8,847		1,497	317	1,180
$250,000 to < $1 million	575	4,921	0.116846	442	51	391
$1 million to < $5 million	388	2,885	0.134489	284	38	246
$5 million to < $10 million	159	645	0.246512	117	28	89
$10 million to < $50 million	651	3,724	0.174812	325	56	269
$50 million to < $100 million	418	1,249	0.334668	192	64	128
$100 million to < $250 million	329	982	0.335031	305	102	203
$250 million to < $500 million	165	562	0.293594	234	68	166
$500 million to < $1 billion	109	447	0.243849	234	57	177
$1 billion to $5 < billion	143	709	0.201693	482	97	385
$5 billion to < $20 billion	38	297	0.127946	273	34	239
$20 billion or more	17	186	0.091398	244	22	222
Total	4,870	25,454		4,629	934	3,695

Source: TIGTA computation.

We then added our allocation of unknown returns to the identified NOL and non-NOL returns to determine our estimates of NOL and non-NOL returns examined as shown in Figure 3.

Figure 3: Estimation of Returns Examined - FY 2011

Description Ending Assets	Identified NOL Returns Examined	Unknown Return Examinations Allocated To NOL	Estimated NOL Returns Examined	Identified Non-NOL Returns Examined	Unknown Return Examinations Allocated to Non-NOL	Estimated Non-NOL Returns Examined	Returns Examined
From Figure 1	Col. D			Col. E			
From Figure 2		Col. F			Col. G		
A	B	C	D = B + C	E	F	G = E + F	H = D + G
Under $250,000	1,878	317	2,195	6,969	1,180	8,149	10,344
$250,000 to < $1 million	575	51	626	4,346	391	4,737	5,363
$1 million to < $5 million	388	38	426	2,497	246	2,743	3,169
$5 million to < $10 million	159	28	187	486	89	575	762
$10 million to < $50 million	651	56	707	3,073	269	3,342	4,049
$50 million to < $100 million	418	64	482	831	128	959	1,441
$100 million to < $250 million	329	102	431	653	203	856	1,287
$250 million to < $500 million	165	68	233	397	166	563	796
$500 million to < $1 billion	109	57	166	338	177	515	681
$1 billion to < $5 billion	143	97	240	566	385	951	1,191
$5 billion to < $20 billion	38	34	72	259	239	498	570
$20 billion or more	17	22	39	169	222	391	430
Total	4,870	934	5,804	20,584	3,695	24,279	30,083

Source: TIGTA computation.

We then computed the overall examination coverage by dividing FY 2011 Returns Examined by PY 2010 Returns filed. We repeated the process for NOL and non-NOL returns to compute the FY 2011 NOL and non-NOL Coverage Rates as shown in Figure 4.

Figure 4: Corporation Examination Coverage - FY 2011

Description Ending Assets	FY 2011 Returns Examined	PY 2010 Returns Filed	FY 2011 Coverage Rate	FY 2011 Estimated NOL Returns Examined	PY 2010 NOL Returns Filed	FY 2011 NOL Coverage Rate	FY 2011 Estimated Non-NOL Returns Examined	FY 2011 Non-NOL Coverage Rate
From Figure 3	Col. H			Col. D			Col. G	
From Report Figure 5		Col. 2			Col. 4			
A	B	C	D = B / C	E	F	G = E / F	H	I = H/(C–F)
Under $250,000	10,344	1,428,584	0.72%	2,195	661,245	0.33%	8,149	1.06%
$250,000 to < $1 million	5,363	327,537	1.64%	626	141,906	0.44%	4,737	2.55%
$1 million to < $5 million	3,169	162,348	1.95%	426	67,028	0.64%	2,743	2.88%
$5 million to < $10 million	762	27,215	2.80%	187	11,624	1.61%	575	3.69%
$10 million to < $50 million	4,049	26,862	15.07%	707	12,362	5.72%	3,342	23.05%
$50 million to < $100 million	1,441	5,750	25.06%	482	2,698	17.87%	959	31.42%
$100 million to < $250 million	1,287	5,365	23.99%	431	2,339	18.43%	856	28.29%
$250 million to < $500 million	796	2,761	28.83%	233	1,166	19.98%	563	35.30%
$500 million to < $1 billion	681	1,863	36.55%	166	756	21.96%	515	46.52%
$1 billion to < $5 billion	1,191	2,069	57.56%	240	799	30.04%	951	74.88%
$5 billion to < $20 billion	570	656	86.89%	72	236	30.51%	498	118.57%
$20 billion or more	430	326	131.90%	39	102	38.24%	391	174.55%
Total	30,083	1,991,336	1.51%	5,804	902,261	0.64%	24,279	2.23%

Source: TIGTA computation.

Appendix XVI

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

COMMISSIONER
LARGE BUSINESS AND
INTERNATIONAL DIVISION

August 14, 2014

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR INSPECTIONS AND EVALUATIONS

FROM: Heather C. Maloy For Daniel W. O'Donnell
Commissioner, Large Business and International Division

SUBJECT: Response to Draft Audit Report, *The Internal Revenue Service Administered Corporate Net Operating Losses Efficiently and Effectively; However, Financial Reporting Transparency Could Be Improved" (# IE-13-015)*

Thank you for sharing the Treasury Inspector General for Tax Administration (TIGTA) draft report "The Internal Revenue Service Administered Corporate Net Operating Losses Efficiently and Effectively; However, Financial Reporting Transparency Could Be Improved" (#IE-13-015).

Your overall objective was to evaluate the IRS plans, activities and program to administer tax laws for corporate net operating losses (NOLs) and NOL carryovers (NOL C/Os). To accomplish the object, you:

1. Determined the relative volume and size of corporate NOLs, Net Operating Loss Deductions (NOLDs) and NOL C/Os.
2. Determined the compliance risk associated with NOLs.
3. Determined the IRS examination coverage and examination results of returns filing corporate NOLs, NOLDs, and NOL C/Os.
4. Determined the programs, processes, methods, and techniques the IRS employs to correct corporate returns involving NOLs, NOLDs, and NOL C/Os that were due to aggressive tax planning (ATP) schemes using NOLs.

We appreciate the result of your review based on the stated objectives, especially the findings indicating that, in spite of the significant increases in NOL filings due to economic downturn, IRS was effective and efficient in handling this increase.

1. NOL carryback claims more than doubled between prior year (PY) 2007 and PY 2010 from 54,618 claims to 114,223 with claims increasing from nearly $7.8 billion to $68.5 billion. IRS is responsible for expeditious processing of these claims and ensuring the validity. IRS was able to reduce interest paid by more than 50 percent between PY 2009 and PY 2010, a clear indication of our increased efficiency.

2. Although our coverage rate of NOL's was on average 1.5 percent during the audit period, our focus on CIC audits allowed us to capture a substantial portion of NOL assessment dollars.
3. The U.S. Tax System contains several disclosure and anti-abuse provisions to deter aggressive NOL transactions, such as Form M-3 and Uncertain Tax Positions (UTP) along with Internal Revenue Code Sections 269, 382, 383 and 384. The M-3 and UTP disclosures are required from the largest corporations with the most substantial NOL dollars, and IRS examines the very largest corporations on a constant basis applying the NOL limitation rules.

We do, however, respectfully disagree with your recommendation that the Chief Financial Officer should include a note in other accompanying unaudited information to the IRS financial statements listing the amount, net present value, and description of the corporate NOL carryforward amounts' impact on future tax revenues. We outline the reasons for the disagreement in the attachment to this memorandum.

If you have any questions, please contact Robin Canady, Chief Financial Officer, at (202) 317-4142 or John Pekarik, Associate Chief Financial Officer, at (202) 803-9151.

Attachment

RECOMMENDATION 1
The Chief Financial Officer should include as a note in other accompanying unaudited information to the financial statements the amount, net present value, and description of the corporate NOL carryforward amounts' impact on future tax revenues.

CORRECTIVE ACTION
The IRS disagrees with this recommendation. The IRS Chief Financial Officer (CFO) consulted with the Department of the Treasury Office of Tax Analysis (OTA) and Deputy CFO; the IRS Office of Research, Analysis & Statistics (RAS); and the Government Accountability Office (GAO), and have concluded this disclosure is not required by existing federal accounting standards as confirmed by GAO and it is very unclear the value of reporting on the impact of the NOL carryforward as a separate element affecting revenue collections in the financial statements.

The CFO had detailed discussions with the Treasury OTA, who commented generally on the approach taken by TIGTA, and who would have to agree to support the recreation of this yearly calculation because all current disclosures related to all revenue projections or impacts must be provided by OTA to GAO for inclusion in the IRS financial statements. OTA describes the present value calculation as a fairly rough estimate with a very broad confidence interval and shared with TIGTA that they do not believe the present value calculation adds value to reporting on the unused NOL, when the TIGTA report also acknowledges not all NOLs will be used before they expire. RAS indicated that while conceptually easy for an individual C Corporation to determine their own NOL Net Present Value (NPV), providing an aggregate NPV would be complex and provide little certainty, as it would be dependent on a significant number of assumptions that, made differently, would likely lead to very different results.

While the amounts reported in other accompanying information are not required to be fully audited, GAO historically performs procedures on the reported amounts to validate the methodology and to assess the accuracy of the data used. The IRS is uncertain as to the measurability and methodology for this NPV calculation which may be too meaningless to provide to GAO for its review. Since this disclosure is not required by OMB A-136, we do not believe the benefit of trying to derive a meaningful calculation would outweigh the burden of doing so.

IMPLEMENTATION DATE
Not Applicable

RESPONSIBLE OFFICIAL
Chief Financial Officer