

# TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



## **Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139 That Are Based on the CARES Act Net Operating Loss Carryback Provisions**

August 31, 2022

Report Number: 2022-35-049

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

# HIGHLIGHTS: Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139 That Are Based on the CARES Act Net Operating Loss Carryback Provisions

Final Audit Report issued on August 31, 2022

Report Number 2022-35-049

## Why TIGTA Did This Audit

This audit was initiated to assess the IRS's efforts to ensure corporate taxpayers' compliance with the net operating loss provisions pertaining to Form 1139, *Corporate Application for Tentative Refund*.

## Impact on Tax Administration

Provision 2303 of the *Coronavirus Aid, Relief, and Economic Security (CARES) Act*, signed into law on March 27, 2020, made several modifications that temporarily repealed certain restrictions imposed by the *Tax Cuts and Jobs Act* affecting net operating losses. The CARES Act allows a taxpayer with a net operating loss arising in a taxable year beginning in 2018, 2019, or 2020 to carry that loss back to each of the five preceding tax years. The taxpayer can also elect to relinquish the entire carryback period for any taxable year's net operating loss and instead carry all net operating losses forward. Once made, this election is irrevocable.

## What TIGTA Found

During the period March 27, 2020, to March 31, 2021, 17,537 taxpayers submitted Form 1139 involving carrybacks to cover 19,262 loss tax years. The IRS issued a total of \$17.4 billion in tentative refunds to 12,119 of these taxpayers. Despite the large volume of Forms 1139 submitted, the business tax returns selected for examination represent a relatively low percentage of net operating loss tax years claimed on the Form 1139. From March 27, 2020, through July 26, 2021, the Small Business/Self-Employed Division selected a total of 12,760 Forms 1120, *U.S. Corporation Income Tax Return*, for examination of which 36 (less than 0.30 percent) involved a "loss" year claimed on the Form 1139. Similarly, the Large Business and International Division selected a total of 5,214 Forms 1120 for examination of which 406 (7.8 percent) involved a "loss" year claimed on the Form 1139. Further, the IRS is not assessing the potential risk these CARES Act provisions pose to tax administration in order to determine whether to adjust examination coverage.

TIGTA reviewed eight Form 1120 examinations that the Small Business/Self-Employed Division closed and found the IRS examinations resulted in return adjustments on five cases (62.5 percent) that reduced the net operating loss that was carried back. Per the net operating loss provisions, Internal Revenue Code § 172, part of the tentative refunds issued in the five cases should have been recaptured. The examiner did not always take the steps to recapture the tentative refund issued to the taxpayer. TIGTA performed similar reviews of Large Business and International Division examination cases and did not find any exceptions.

After TIGTA shared these observations with the Small Business/Self-Employed Division, management took immediate corrective actions to update the examination guidance for both the Small Business/Self-Employed and Large Business and International Divisions and is in the process of taking the steps necessary to recover the excess tentative refunds issued.

## What TIGTA Recommended

TIGTA recommended that the Small Business/Self-Employed Division: 1) track and monitor the examination results for the 25 open examinations of Forms 1120 with reported net operating losses and an associated Form 1139 presented in this report (excluding Joint Committee Refund cases); 2) use the examination results from Recommendation 1 to assess whether to increase the number of examinations of Forms 1120 with reported net operating losses and an associated Form 1139; and 3) review the examination results and computations of proposed net operating loss adjustments for the 25 open examinations presented in this report (excluding Joint Committee Refund cases), to determine if the interim guidance regarding net operating losses is being properly followed. IRS management agreed with all three recommendations.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

## U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20024

August 31, 2022

### MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

**FROM:**

*Heather Hill*

Heather M. Hill  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139 That Are Based on the CARES Act Net Operating Loss Carryback Provisions (Audit # 202130525)

This report presents the results of our review to assess the Internal Revenue Service's efforts to ensure corporate taxpayers' compliance with the net operating loss provisions pertaining to Form 1139, *Corporate Application for Tentative Refund*, application under the *Coronavirus Aid, Relief, and Economic Security Act of 2020*.<sup>1</sup> This review is part of our Fiscal Year 2022 Annual Audit Plan and addresses the major management and performance challenge of *Improving Tax Compliance*.

Management's complete response to the draft report is included as Appendix III.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

---

<sup>1</sup> Pub. L. No. 116-136, 134 Stat. 281.

## Table of Contents

<b><u>Background</u></b> .....	Page 1
<b><u>Results of Review</u></b> .....	Page 4
<a href="#"><u>Few Businesses Filing Form 1139 Have Their Corporate Income Tax Returns Selected for Examination Despite the Large Amount of Tentative Refunds Issued</u></a> .....	Page 4
<a href="#"><u>Recommendation 1:</u></a> .....	Page 8
<a href="#"><u>Recommendation 2:</u></a> .....	Page 9
<a href="#"><u>Examiners Did Not Always Consider the Impact Form 1120 Examination Results Had on Net Operating Loss Carrybacks</u></a> .....	Page 9
<a href="#"><u>Recommendation 3:</u></a> .....	Page 11
 <b>Appendices</b>	
<a href="#"><u>Appendix I – Detailed Objective, Scope, and Methodology</u></a> .....	Page 12
<a href="#"><u>Appendix II – Form 1139, <i>Corporation Application for Tentative Refund</i></u></a> .....	Page 14
<a href="#"><u>Appendix III – Management’s Response to the Draft Report</u></a> .....	Page 15
<a href="#"><u>Appendix IV – Glossary of Terms</u></a> .....	Page 19
<a href="#"><u>Appendix V – Abbreviations</u></a> .....	Page 20

## **Background**

Fluctuations in income and expenses can cause a taxpayer to have substantial profits in one tax year and losses in another. For business returns, a net operating loss (NOL) generally occurs when a taxpayer's allowable deductions exceed its gross income for a tax year, resulting in negative income.<sup>1</sup> A taxpayer with an NOL generally does not owe any income taxes and may be able to carry back any excess loss to offset income reported in earlier tax years, resulting in a refund of taxes already paid. Any loss remaining after applying the NOL to preceding tax years may be carried forward to lower taxes in future tax years. In general, for NOLs arising in tax years beginning after Tax Year (TY) 2017, the *Tax Cuts and Jobs Act* (TCJA) removed the option for most entities to carry back an NOL and allowed the taxpayer to carryforward an NOL subject to an 80 percent of taxable income limitation;<sup>2</sup> however, as described below, subsequent legislation provided for NOL carrybacks.

### **CARES Act-enacted NOL legislation changes**

To provide liquidity to businesses during the COVID-19 pandemic, the *Coronavirus Aid, Relief, and Economic Security* (CARES) *Act of 2020*, signed into law on March 27, 2020, included tax measures to help businesses by reducing certain tax obligations.<sup>3</sup> In some cases, the tax measures, such as the changes to NOL rules, led to tax refunds.

The CARES Act reversed the TCJA restriction on NOL carrybacks. Section 2303 of the CARES Act allows a taxpayer with a NOL arising in a taxable year beginning after December 31, 2017, and before January 1, 2021, *i.e.*, TYs 2018, 2019, or 2020, to carry that loss back to each of the five taxable years preceding the taxable year of such loss while also providing a temporary repeal of the 80 percent taxable income limitation for NOL deductions enacted by the TCJA. Taxpayers may elect to relinquish the entire carryback period for any taxable year's NOL and instead carry all NOLs forward. Once made, this election is irrevocable.<sup>4</sup> Figure 1 shows the impact that the CARES Act has on NOL carryback and carryforward rules.

---

<sup>1</sup> See Appendix IV for glossary of terms.

<sup>2</sup> Pub. L. No. 115-97, 131 Stat 2054 (2017).

<sup>3</sup> Pub. L. No. 116-136, 134 Stat. 281.

<sup>4</sup> Internal Revenue Code (I.R.C.) § 172(b)(3).

**Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139  
That Are Based on the CARES Act Net Operating Loss Carryback Provisions**

**Figure 1: NOL Carryback and Carryforward Rules Due to the CARES Act**

			Limitation on NOL Utilization in Carryforward Period		
	Carryback Period	Carryforward Period	Tax Years Before TY 2018	Tax Years 2018 - 2020	Tax Years After TY 2020
<b>Pre-2018 NOLs</b>	2 years	20 years	Not limited	Not limited	Not limited
<b>TYs 2018 - 2020 NOLs</b>	5 years	Indefinite	N/A	Not limited	80% limitation
<b>Post-2020 NOLs (TCJA)</b>	N/A (no carryback)	Indefinite	N/A	N/A	80% limitation

Source: TIGTA analysis of the TCJA and CARES Act.

The TCJA made the corporate tax rate a flat 21 percent effective for taxable years beginning after December 31, 2017, regardless of tax income level. Tax years prior to TY 2018 generally had higher tax rates (see Figure 2).

**Figure 2: TY 2013 to TY 2017 Federal Corporate Tax Rates**

Taxable Income		Tax Is	Of the Amount Over
Over	But Not Over		
\$0	\$50,000	<b>15%</b>	\$0
\$50,000	\$75,000	\$7,500 + <b>25%</b>	\$50,000
\$75,000	\$100,000	\$13,750 + <b>34%</b>	\$75,000
\$100,000	\$335,000	\$22,250 + <b>39%</b>	\$100,000
\$335,000	\$10,000,000	\$113,900 + <b>34%</b>	\$335,000
\$10,000,000	\$15,000,000	\$3,400,000 + <b>35%</b>	\$10,000,000
\$15,000,000	\$18,333,333	\$5,150,000 + <b>38%</b>	\$15,000,000
\$18,333,333	N/A	<b>35%</b>	\$0

Source: 2013 - 2017 Instructions for Form 1120, U.S. Corporation Income Tax Return.

The ability of businesses to carry back NOLs from TY 2018 through TY 2020 to earlier tax years, due to CARES Act provisions, tends to increase the value of the carryback amounts. For example, a taxpayer with taxable income between \$10 million and \$15 million in TY 2013 and an NOL of \$1 million in TY 2018 could carry back the loss to TY 2013 and generate a refund of \$350,000 (\$1 million x 35 percent). Whereas, prior to the CARES Act, the same NOL would only result in a refund of \$210,000 (\$1 million x 21 percent) based on carrying the NOL forward.

### **Process to carryback losses under the CARES Act**

Business taxpayers with a NOL have a choice of two methods to carry back their loss, each of which has separate rules.<sup>5</sup> A taxpayer may:

<sup>5</sup> Revenue Procedure 2020-24, effective Apr. 9, 2020.

**Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139  
That Are Based on the CARES Act Net Operating Loss Carryback Provisions**

---

- File an Application for Tentative Refund. The Form 1139, *Corporation Application for Tentative Refund*, generally must be filed within one year after the end of the tax year with the reported NOL. A taxpayer can file one form to carry back its loss to all applicable preceding gain years. The primary advantage of filing a tentative refund application using Form 1139 is that the original return with the NOL does not have to be completely processed by the Internal Revenue Service (IRS) before the refund can be approved, thus making the refund “tentative.” This means the refund can be issued prior to verification of the posted tax return. Additionally, a tentative refund is processed prior to referral for examination. While the IRS is required to process tentative refund applications within 90 days, interest must be paid on refunds that are not issued within 45 days.<sup>6</sup>
- File an amended return. Unlike the tentative refund, an amended return has to be filed for each carryback year and must generally be filed within the statutory period of three years from the due date of the loss year return, including extensions. A carryback filed on an amended return is subject to examination criteria on the loss/gain years before allowing the claim. While the IRS is not statutorily required to process amended return carryback claims within 90 days, interest must be paid on refunds that are not issued within 45 days.<sup>7</sup>

**Taxpayers generally receive refunds quicker by filing Form 1139 than amending returns.**

The process for submitting Form 1139 is by paper only. However, due to the COVID-19 pandemic, the IRS temporarily established an e-fax submission method for Form 1139 to enable image-scanning and loading into IRS systems. This facilitated employees’ ability to review Form 1139 cases while on extended telework. The e-fax line was operational from April 17, 2020, to December 31, 2020.

Both the Treasury Inspector General for Tax Administration (TIGTA) and the Government Accountability Office have reviewed the IRS’s processing of the tentative refund applications. TIGTA’s review found some business tentative refund applications associated with identity theft tax accounts and/or with a recent and significant address change were not referred for required fraud review. Additionally, some tentative refund applications were erroneously processed after the filing deadline.<sup>8</sup>

The Government Accountability Office found the IRS did not timely process tentative refund applications resulting in a backlog. The IRS started to miss the 90-day statutory requirement in September 2020 and missed it throughout 2021. As of November 2021, the average time for processing all carryback refunds was 166 days.<sup>9</sup>

---

<sup>6</sup> I.R.C. § 6411(b) and I.R.C. § 6611(e).

<sup>7</sup> I.R.C. § 6611(e).

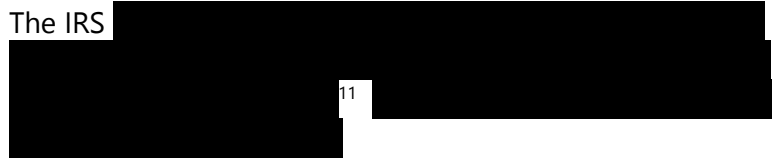
<sup>8</sup> TIGTA, Report No. 2021-46-035, *Assessment of Processes to Verify Tentative Carryback Refund Eligibility* (June 2021).

<sup>9</sup> Government Accountability Office, GAO-22-105291, *COVID-19 Significant Improvements Are Needed for Overseeing Relief Funds and Leading Responses to Public Health Emergencies* (Jan. 2022).

## **Results of Review**

From March 27, 2020, to March 31, 2021, the IRS received 17,537 Forms 1139 involving carrybacks from business taxpayers covering 19,262 loss tax years.<sup>10</sup>

The IRS



Because the Form 1139 can be used to claim tentative refunds for different reasons, *e.g.*, unused general business credit, unused research credit, net capital loss, *etc.*, the IRS [REDACTED] for this review, the IRS provided Form 1139 data that involve carrybacks regardless of the reason.

## **Few Businesses Filing Form 1139 Have Their Corporate Income Tax Returns Selected for Examination Despite the Large Amount of Tentative Refunds Issued**

According to the IRS, refunds from Form 1139 are a priority and should be issued as timely as possible. If the Form 1139 was able to be processed, the IRS allowed tentative refunds immediately. If problems are found later, *i.e.*, through examination, the IRS is required to reverse the tentative refund and recapture the refunds from the taxpayers. To provide financial assistance to businesses quickly, there was an inherent risk that some refunds were issued based on intentionally or unintentionally overstated NOL carryback amounts on Forms 1139 and the Government may not recover the associated erroneous refund payments.

### **A large amount of tentative refunds has been issued**

We matched the 17,537 taxpayers referenced previously to the IRS's tentative refund data. We estimate that as of May 27, 2021, the IRS issued \$17.4 billion tentative refunds based on submitted Forms 1139. Figure 3 shows that 12,119 taxpayers were allowed tentative refunds.<sup>12</sup>

---

<sup>10</sup> The tax year count is higher than the number of taxpayers because some taxpayers claimed losses for more than one tax year.

<sup>11</sup> See Appendix II for a copy of Form 1139.

<sup>12</sup> Of the 12,119 taxpayers, 97 had a total of \$331.4 million refunds reversed.



**Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139  
That Are Based on the CARES Act Net Operating Loss Carryback Provisions**

**Figure 3: Form 1139 Tentative Refunds Issued**

Applied Carryback to "Gain" Tax Year	Tentative Refunds Issued
2013	\$2,242,815,830
2014	\$4,137,020,347
2015	\$2,643,797,635
2016	\$4,441,298,387
2017	\$2,666,284,521
2018	\$1,137,412,476
2019	\$170,704,004
<b>Total</b>	<b>\$17,439,333,200</b>
<b>Number of Taxpayers</b>	<b>12,119<sup>13</sup></b>

*Source: TIGTA analysis of the IRS's Form 1139 and refund data.*

Given that the IRS [REDACTED] the IRS cannot quantify the [REDACTED] we were unable to estimate the percentage of the \$17.4 billion tentative refunds associated with NOL carrybacks.

As explained previously, the CARES Act allowed taxpayers with an NOL arising in TYs 2018, 2019, or 2020 to carry that loss back to each of the five tax years preceding the tax year of such loss. This means TY 2013 would be the earliest eligible year, *i.e.*, for a TY 2018 NOL, and TY 2019 would be the last eligible year, *i.e.*, for a TY 2020 NOL. The Small Business/Self-Employed (SB/SE) and Large Business and International (LB&I) Divisions have not adjusted their annual examination plans or return selection methodology to address NOL carryback changes under the CARES Act.

According to the Standards for Internal Control in the Federal Government, a strong control environment requires management to identify, analyze, and respond to risks.<sup>14</sup> The identification of risks includes considering changes within the entity's external environment factors, such as new or amended laws and regulations. The enactment of the CARES Act represents new risks and the IRS should consider the impact on its compliance enforcement efforts.

<sup>13</sup> This is less than 17,537 taxpayers because not all Forms 1139 that the IRS received had been processed (still open), and some Forms 1139 were not valid.

<sup>14</sup> Government Accountability Office, GAO-14-704G, *Standards for Internal Control in the Federal Government* (Sept. 2014).

**Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139  
That Are Based on the CARES Act Net Operating Loss Carryback Provisions**

---

Forms 1139 are not separate tax modules, *i.e.*, accounts, as they report adjustments made by the taxpayer due to NOL deductions and other adjustments, such as credits based on the taxpayer's originally filed Form 1120. The IRS selects Form 1120 for examination without regard to the Form 1139 filing. When examining a Form 1120 return, the examiner would need to consider all adjustments, *e.g.*, Form 1139, associated with that tax year's Form 1120 return as part of the required audit steps.

**The SB/SE and LB&I Divisions have not adjusted their annual examination plans or return selection methodology to address NOL carryback changes under the CARES ACT.**

According to the SB/SE Division, it has a workstream that conducts examinations of taxpayer claims, and although tentative allowances claimed on Form 1139 are not claims for refund, they are included within the Form 1120 claim workstream. However, the SB/SE Division has not implemented additional audit selection steps to identify Forms 1139 for examination based on potential inflated NOLs.<sup>15</sup> Moreover, the SB/SE Division is not specifically tracking examination results of NOLs in which the taxpayer filed a Form 1139 associated with the NOL. For example, when NOLs are adjusted, the examination results are not summarized.

Although tentative allowances claimed on Form 1139 are not claims for refund, the LB&I Division also includes them within the Form 1120 claim workstream. However, it does not specifically track examination results of NOLs in which the taxpayer filed a Form 1139. During the workload selection process, the LB&I Division treats all claims for refunds and requests for tentative allowances the same. In the examination, the LB&I Division audits the tax return filed by the taxpayer and the claim, if any.

### **Few Form 1120 examinations have been conducted to address the NOL year claimed on the Form 1139**

An IRS examination is a review of an organization's accounts and financial data to ensure that information is reported correctly according to the tax laws and to verify that the reported tax amount is correct. Examinations are a critical Government control procedure.

The IRS may review any claim for refund or credit. However, the IRS must review a refund or credit of more than \$2 million (\$5 million for C corporations) and provide a report to the Joint Committee on Taxation, *i.e.*, referred to here as Joint Committee Refund Case. A Joint Committee Refund Case is assigned to an IRS examiner and either examined or surveyed.<sup>16</sup> The tentative refund claimed on the Form 1139 could give rise to a Joint Committee Refund Case, and the tentative refund could be paid prior to the IRS's review.

In December 2014, the *Tax Increase Prevention Act of 2014* increased the threshold for Joint Committee Refund Cases from \$2 million to \$5 million for C corporations.<sup>17</sup> As a result, fewer C corporation Forms 1139 are now subject to Joint Committee review as compared to when the NOL five-year carryback was allowed previously (before the TCJA was enacted).

---

<sup>15</sup> A claim for refund is an amended return or written request that asks for some amount of money to be refunded, whether or not it also involves an abatement.

<sup>16</sup> A survey is a decision to accept a return without examination.

<sup>17</sup> Pub. L. No. 113-295 (2014).

**Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139  
That Are Based on the CARES Act Net Operating Loss Carryback Provisions**

---

We analyzed the Forms 1120 that the SB/SE and LB&I Divisions selected for examination on or after the CARES Act was enacted and compared those to the Forms 1139 received during the period March 27, 2020, to March 31, 2021.<sup>18</sup> We found that the Forms 1120 selected for examination represent a relatively low percentage of NOL tax years claimed on the Form 1139.

As of July 26, 2021, the SB/SE Division selected a total of 12,760 Forms 1120 for examination. Comparison of the selected returns against the Forms 1139 received disclosed that only 36 out of the 12,760 Form 1120 returns (less than 0.30 percent) involved a “loss” year claimed on the Form 1139 (see Figure 4).<sup>19</sup>

**Figure 4: Comparison of SB/SE Division Selected  
Forms 1120 for Examination to Forms 1139 Received**

<b>Examination Status as of July 26, 2021</b>	<b>Number of Forms 1120 Selected</b>	<b>Number of Forms 1120 That Has a Tax “Loss” Year on Forms 1139</b>
Closed	1,631	8
Closed As Not Examined	3,149	3
Still Open	7,980	25
<b>Total</b>	<b>12,760</b>	<b>36</b>

*Source: TIGTA analysis of Form 1139 and SB/SE Division Form 1120 data.*

As of July 2021, the LB&I Division selected a total of 5,214 Forms 1120 for examination. Comparison of the selected returns against the Forms 1139 received disclosed 406 of the 5,214 Form 1120 returns (7.8 percent) involved a “loss” year claimed on the Form 1139 (see Figure 5).

---

<sup>18</sup> The IRS does not have a return “select date” field. As such, the IRS used the “creation date” when providing the Form 1120 data extract to TIGTA. The creation date is the date the return record was established on the Audit Information Management System.

<sup>19</sup> By comparison, audit coverage rates for corporations with assets between \$10 million and \$50 million for Tax Year 2019 was 1.1 percent, and the audit coverage raises to 24 percent for corporations with assets of \$20 billion or more. IRS Data Book, Fiscal Year 2021, p. 36, Table 17.

**Figure 5: Comparison of LB&I Division Selected  
Forms 1120 for Examination to Forms 1139 Received**

Examination Status as of July 2021	Number of Forms 1120 Selected	Number of Forms 1120 That Has a Tax "Loss" Year on Forms 1139
Closed in Fiscal Year (FY) 2020 <sup>20</sup>	21	■
Closed in FY 2021	250	8
Closed as Not Examined in FY 2020 <sup>21</sup>	78	■
Closed as Not Examined in FY 2021	1,926	88
Open (passed the "selected but not assigned" stage)	2,939	308
<b>Total</b>	5,214	■

*Source: TIGTA analysis of Form 1139 and LB&I Division Form 1120 data.*

The IRS agreed with the data presented in Figures 4 and 5. However, the IRS noted the data in those two figures do not include taxpayers that could have filed the Form 1139 as a result of the CARES Act but were selected for examination prior to March 27, 2020. For example, a TY 2018 Form 1120 return examination started in January 2020 would be excluded in TIGTA's review. We purposely focused on returns selected on or after March 27, 2020, because we wanted to assess the IRS's actions to ensure compliance with the CARES Act after enactment. Forms 1120 selected prior to March 27, 2020, would not represent intentional coverage of Form 1139 NOL carryback impact under the CARES Act.

The IRS also stated that TIGTA started this review too early in the examination "selection" process to get a good match against Forms 1139. Many of the Forms 1139 were not yet received when return examination started in FY 2020. Examinations started in early to mid-2020 would not have been "in lieu of Form 1139 claims" because the claims would not yet have been filed or sent to the field. We acknowledge this; however, given the new NOL provisions under the CARES Act, we believe it is important to catch any problems early for timely correction. As evidenced in the next section, we identified a problem in need of immediate action in order to protect the Government's revenue.

According to the IRS, the volume of cases available for examination is taxpayer driven. The IRS does not have control over the volume of Forms 1139 received. The IRS only has control over its examination plan which, according to the IRS, provides balanced examination coverage across the various workstreams. However, despite the increase in the number of Forms 1139 filed, the IRS is not assessing the potential risk these CARES Act provisions pose to tax administration in order to determine whether to adjust examination coverage if warranted. As stated previously, the Standards for Internal Control in the Federal Government requires management to identify,

<sup>20</sup> According to the LB&I Division, there could be some 2018 and 2019 Form 1120 returns selected prior to March 27, 2020, that the taxpayer later filed Form 1139 to carry back the NOL for tentative refund under the CARES Act not included in the analysis.

<sup>21</sup> According to the LB&I Division, training contributed to cases closed in FYs 2020 and 2021 as not examined. To ensure a sufficient number of returns, the training managers requested more returns than ended up being worked.

analyze, and respond to risks. The identification of risks includes considering changes within the entity's external environment factors, such as new or amended laws and regulations. We believe the IRS should adjust the examination plan to provide an increase in specific audit coverage for Form 1139 filings that surged as a result of the CARES Act enactment.

Given so few examinations of Form 1120 returns involving the tax year claimed on Forms 1139 (see Figures 4 and 5), the risk increases that the Government paid refunds to taxpayers based on inaccurate Forms 1139. The IRS could benefit from implementing additional audit selection processes that consider the risk of potential overstated refunds based on Form 1139 evaluation experience. The examination results specific to the Form 1139 filings should be tracked and provided to management to identify the Form 1139 filings risk level. The examination data will enable management to implement the most appropriate examination coverage and additional audit selection processes based on the level of risk found.

The Commissioner, SB/SE Division, should:

**Recommendation 1:** Track and monitor examination results for the 25 "still open" examinations of Forms 1120 with reported NOL and an associated Form 1139 reported in Figure 4 of this report, excluding Joint Committee Refund cases which currently have specific monitoring requirements in place.

**Management's Response:** IRS management agreed with this recommendation and will track and monitor the results of these 25 "still open" examinations for a maximum period of 18 months.

**Recommendation 2:** Use the examination results from Recommendation 1 to assess whether to increase the number of examinations of Forms 1120 with reported NOL and an associated Form 1139.

**Management's Response:** IRS management agreed with the recommendation and will analyze the examination results for the 25 "still open" cases referenced in Recommendation 1. Based on their analysis, the IRS will determine if an increase in examinations is warranted for Forms 1120 with a reported NOL and an associated Form 1139 and make recommendations as appropriate.

## **Examiners Did Not Always Consider the Impact Form 1120 Examination Results Had on Net Operating Loss Carrybacks**

To determine what the IRS found from its examinations of Forms 1120 involving a tax year claimed as the "loss" year on Forms 1139, we reviewed pertinent IRS examination results and documentation.

### **SB/SE Division examinations**

We reviewed all eight Form 1120 examinations that the SB/SE Division closed as shown in Figure 4. For each of the eight cases, we looked at the Form 1139 pertaining to the tentative refund claims and examination results to review the tentative refund claims and the results of the SB/SE Division's examination. We found the IRS examination resulted in return adjustments

**Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139  
That Are Based on the CARES Act Net Operating Loss Carryback Provisions**

on five (62.5 percent) of the eight cases that reduced the NOL amount that was carried back. There were no changes for the three remaining cases.

Per NOL provisions in Internal Revenue Code (I.R.C.) § 172, part of the tentative refunds issued in the five cases should have been recaptured ("clawed back"). The examiner did not always take the steps to recapture the tentative refund issued to the taxpayer based on the Form 1139.

Figure 6 presents a hypothetical example to illustrate how examination NOL adjustments affect NOL carrybacks and impact tentative refunds issued.

**Figure 6: Illustration of How NOL Examination  
Adjustments Affect Form 1139 Tentative Refunds Issued**

Taxpayer Reported NOL Amount on TY 2018 Filed Form 1120			\$ (1,000,000)	
IRS Examination Adjustment on the NOL			\$ 300,000	
Adjusted NOL Available Per IRS Examination			\$ (700,000)	
Impact of Examination NOL Adjustments on Form 1139 Tentative Refunds Issued				
	TY 2013		TY 2014	
	Return	Examination	Return	Examination
Taxable Income Per Filed Return	\$800,000	\$800,000	\$200,000	\$200,000
Tax Per Return Filed	\$272,000	N/A	\$61,250	N/A
Apply NOL Available From TY 2018	\$800,000	\$700,000	\$200,000	\$0
Taxable Income After Applying NOL Carryback	\$0	\$100,000	\$0	\$200,000
Processed Form 1139 (Refund to Taxpayer)	\$272,000	N/A	\$61,250	N/A
Adjusted Tax Per Examination	\$0	\$22,250	\$0	\$61,250
Excess Refund Per Examination	N/A	\$22,250	N/A	\$61,250

Source: TIGTA-created example.

As noted in Figure 6, the impact of the examination of TY 2018 would result in the recapture of tax of \$22,250 for TY 2013 and \$61,250 for TY 2014 as a consequence of the reduced NOL available from TY 2018. This process would require the examiner to pick up TYs 2013 and 2014 and consider the processed Form 1139 refund issued with respect to the reduced NOL for TY 2018 from the examination.

However, in some instances when the examiner completed the Form 4549, *Report of Income Tax Examination Changes*, the examiner did not consider the impact of the reduced NOL, and the tax computations did not incorporate refunds already issued based on Forms 1139 filed as NOLs.

Based on our results, the SB/SE Division re-reviewed these cases and researched the taxpayers' accounts. As of April 2022, the SB/SE Division was working to identify the appropriate steps necessary to recover ("claw back") the excess tentative refunds issued.

## **LB&I Division examinations**

We also reviewed all nine Form 1120 examinations closed in FYs 2020 and 2021 (see Figure 5). Six cases were closed as no change, and the resolution for the remaining three cases were handled appropriately.

## **Management Actions**

Even though there was not a significant number of closed examination cases for TIGTA to review at the time of our audit, what we found with the SB/SE Division examinations indicated a weakness that needed to be addressed in order to protect the Government's revenue.

We shared our results of SB/SE Division examinations with IRS management. They concurred and took timely corrective actions. On February 7, 2022, the IRS issued interim guidance to SB/SE and LB&I Divisions' examination operations. The memorandum provided guidance on steps to take when examining tax returns reporting a NOL. To help ensure that all actions taken by the taxpayer are considered during the examination, the procedures include requiring examiners to ask the taxpayer if the loss was carried back. Additionally, the examiner must review the taxpayer's account at the beginning of the examination and again during the preparation of the proposed tax adjustment report for all eligible carryback years in search of indications the loss was carried back. According to the IRS, the procedure changes will ultimately be incorporated into the Internal Revenue Manual.

Furthermore, to immediately raise examiners' awareness of the examination procedures outlined in the interim guidance, IRS management took the following supplementary actions to help ensure that examiners understand their responsibilities for and are addressing the impact of any NOL carrybacks in their examinations:

- On February 10, 2022, the SB/SE Division requested all its Examination Directors (Field, Campus, and Special) distribute the interim guidance throughout their organizations. Also, the SB/SE Division's Examination Quality and Technical Support group submitted an article for inclusion in the next quarterly *Technical Digest* publication.
- On February 14, 2022, the LB&I Divisions included an article in its weekly newsletter *LB&I Frontline*. This publication is distributed to all LB&I Division frontline employees.

**Recommendation 3:** The Commissioner, SB/SE Division should review the examination results and computations of proposed NOL adjustments for the 25 "still open" Form 1120 examinations with associated Forms 1139, as referenced in Figure 4, excluding Joint Committee Refund cases which currently have specific review requirements in place, to determine if the interim guidance regarding NOLs is being properly followed.

**Management's Response:** IRS management agreed with the recommendation and will review the examination results and computations of the 25 "still open" examinations for a maximum period of 18 months to evaluate if the procedures identified in the interim guidance memorandum, dated February 7, 2022, are being properly followed. IRS will take action to address deviations, as necessary.



## **Appendix I**

### **Detailed Objective, Scope, and Methodology**

The overall objective of this audit was to assess the IRS's efforts to ensure corporate taxpayers compliance with NOL provisions pertaining to Form 1139 tentative refunds application under the CARES Act. To accomplish our objective, we:

- Obtained information from the IRS regarding controls in place to ensure the NOL amounts claimed on Form 1139 are accurate and that the claimed decrease in taxes for carryback years are valid.
- Assessed the Forms 1139 received and the IRS's examination coverage of those Forms 1139. To accomplish this, we:
  1. Obtained from the Wage and Investment Division a data extract of Forms 1139 received on or after March 27, 2020, through March 31, 2021, that involved a carryback.
  2. Obtained from the LB&I and SB/SE Divisions a data extract of Forms 1120 selected on or after March 27, 2020, for examination.
  3. Determined the number of Forms 1120 selected for examination that involve a "loss" year claimed on Form 1139 by comparing the Form 1139 and Form 1120 data extracts from Steps 1 and 2.
  4. Reviewed the IRS's closed examinations on Forms 1120 that involve a "loss" year claimed on the Form 1139.
- Determined the tentative refunds that the IRS issued as a result of Forms 1139 received on or after March 27, 2020, through March 31, 2021. We estimated the tentative refund amounts by matching the taxpayers in the Form 1139 data extract with the IRS's Business Master File tax adjustment data (Transaction Codes 295 and 294) through May 27, 2021.

### **Performance of This Review**

This review was performed with information obtained from Wage and Investment, SB/SE, and LB&I Divisions during the period May 2021 through April 2022. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Major contributors to the report were Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations); Christina Dreyer, Director; Timothy Greiner, Director; Lee Hoyt, Audit Manager; and Julia Tai, Lead Auditor.



## **Validity and Reliability of Data From Computer-Based Systems**

We performed tests to assess the reliability of data extracts provided by the IRS. We assessed the accuracy of the Form 1139 data extract by verifying 28 records against the IRS's Correspondence Imaging System. Additionally, we assessed the accuracy of LB&I and SB/SE Divisions' Form 1120 data extract by verifying 14 and 13 records, respectively, against the IRS's Integrated Data Retrieval System. Furthermore, we assessed the accuracy of the Business Master File tax adjustment data by verifying 32 records against the IRS's Integrated Data Retrieval System. We determined that the data were sufficiently reliable for purposes of this report.

## **Internal Controls Methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the process in place for reviewing tentative refund applications and Form 1139 filing consideration in the examination process. We evaluated these controls by interviewing representatives and obtaining information from Wage and Investment Division Accounts Management regarding Form 1139 processing, reviewing IRS procedures, obtaining information from the LB&I and SB/SE Divisions regarding Form 1120 selection for examination, and reviewing closed examination cases that had a Form 1139.

Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139  
That Are Based on the CARES Act Net Operating Loss Carryback Provisions

Appendix II

Form 1139, Corporation Application for Tentative Refund

<b>Form 1139</b> (Rev. October 2018) Department of the Treasury Internal Revenue Service		<b>Corporation Application for Tentative Refund</b> ▶ Go to <a href="http://www.irs.gov/Form1139">www.irs.gov/Form1139</a> for instructions and the latest information. ▶ Do not file with the corporation's income tax return—file separately. ▶ Keep a copy of this application for your records.		OMB No. 1545-0123	
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	
<b>1 Reason(s) for filing.</b> See instructions—attach computation		<b>a Net operating loss (NOL)</b> . . . ▶ \$		<b>c Unused general business credit</b> ▶ \$	
		<b>b Net capital loss</b> . . . ▶ \$		<b>d Other</b> . . . ▶ \$	
<b>2 Return for year of loss, unused credit, or overpayment under section 1341(b)(1) ▶</b>		<b>a Tax year ended</b>		<b>b Date tax return filed</b>	
				<b>c Service center where filed</b>	
<b>3</b> If this application is for an unused credit created by another carryback, enter ending date for the tax year of the first carryback ▶					
<b>4</b> 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 . . . . . <input type="checkbox"/> Yes <input type="checkbox"/> No					
<b>5a</b> Was a consolidated return filed for any carryback year or did the corporation join a consolidated group (see instructions)? <input type="checkbox"/> Yes <input type="checkbox"/> No					
<b>b</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) ▶					
<b>6a</b> If Form 1138 has been filed, was an extension of time granted for filing the return for the tax year of the NOL? . . . <input type="checkbox"/> Yes <input type="checkbox"/> No					
<b>b</b> If "Yes," enter the date to which extension was granted ▶ <b>c</b> Enter the date Form 1138 was filed . ▶					
<b>d</b> Unpaid tax for which Form 1138 is in effect . . . . . ▶ \$					
<b>7</b> If the corporation changed its accounting period, enter the date permission to change was granted . . . . . ▶					
<b>8</b> If this is an application for a dissolved corporation, enter date of dissolution . . . . . ▶					
<b>9</b> Has the corporation filed a petition in Tax Court for the year or years to which the carryback is to be applied? . . . <input type="checkbox"/> Yes <input type="checkbox"/> No					
<b>10</b> 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 . . . . . <input type="checkbox"/> Yes <input type="checkbox"/> No					
<b>Computation of Decrease in Tax</b> See instructions.		<b>preceding</b> <b>tax year ended ▶</b>		<b>preceding</b> <b>tax year ended ▶</b>	
<b>Note:</b> If only filing for an unused general business credit (line 1c), skip lines 11 through 15.		<b>(a) Before carryback</b>		<b>(b) After carryback</b>	
<b>11</b> Taxable income from tax return . . . . .					
<b>12</b> Capital loss carryback (see instructions)					
<b>13</b> Subtract line 12 from line 11 . . . . .					
<b>14</b> NOL deduction (see instructions) . . . . .					
<b>15</b> Taxable income. Subtract line 14 from line 13					
<b>16</b> Income tax . . . . .					
<b>17</b> Alternative minimum tax . . . . .					
<b>18</b> Base erosion minimum tax (Attach Form 8991)					
<b>19</b> Add lines 16 through 18 . . . . .					
<b>20</b> General business credit (see instructions)					
<b>21</b> Other credits (see instructions) . . . . .					
<b>22</b> Total credits. Add lines 20 and 21 . . . . .					
<b>23</b> Subtract line 22 from line 19 . . . . .					
<b>24</b> Personal holding company tax (Sch. PH (Form 1120))					
<b>25</b> Other taxes (see instructions) . . . . .					
<b>26</b> Total tax liability. Add lines 23 through 25					
<b>27</b> Enter amount from "After carryback" column on line 26 for each year . . . . .					
<b>28</b> Decrease in tax. Subtract line 27 from line 26					
<b>29</b> Overpayment of tax due to a claim of right adjustment under section 1341(b)(1) (attach computation)					
<b>Sign Here</b> 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	
Print/Type preparer's name		Preparer's signature		Date	
Firm's name ▶		Check <input type="checkbox"/> if self-employed		PTIN	
Firm's address ▶		Firm's EIN ▶		Phone no.	
<b>Paid Preparer Use Only</b>					
For Paperwork Reduction Act Notice, see separate instructions.					
Cat. No. 11170F Form 1139 (Rev. 10-2018)					

## Appendix III

### Management's Response to the Draft Report



COMMISSIONER  
SMALL BUSINESS/SELF-EMPLOYED DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

August 19, 2022

MEMORANDUM FOR HEATHER M. HILL  
DEPUTY INSPECTOR GENERAL FOR AUDIT  
Amalia C.  
FROM: Lia Colbert Colbert  
Commissioner, Small Business/Self-Employed Division  
SUBJECT: Draft Audit Report – Compliance Efforts Are Needed to Address  
Refund Claims Reported on Form 1139 That Are Based on the  
CARES Act Net Operating Loss Carryback Provisions (Audit #  
202130525)

Digitally signed by Amalia  
C. Colbert  
Date: 2022.08.19  
07:43:13 -04'00'

Thank you for the opportunity to review and comment on the subject draft audit report. The Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 retroactively repealed net operating loss (NOL) deduction limitations created by the Tax Cuts and Jobs Act (TCJA) of 2017. CARES Act Provision 2303 allowed for a five-year carryback opportunity to help taxpayers financially during the COVID-19 pandemic. Between 2017 and 2021, tax laws related to NOL deductions changed three times. At the time of this report, CARES Act provisions have expired and TCJA provisions are in place, which limit the deductibility of NOLs for tax years beginning after December 31, 2020.

Corporations can claim NOL deduction carrybacks by filing a Form 1120-X, *Amended U.S. Corporation Income Tax Return* or a Form 1139, *Corporation Application for Tentative Refund*. The processing of Forms 1139 is a priority, and we established an efax line to intake and facilitate processing. Although a backlog of unprocessed tentative refund applications remain, IRS is taking steps to address this backlog as quickly as possible.

With enactment of the CARES Act, we performed our due diligence in evaluating the audit compliance risk associated with the changes to NOL deductions, just as we did with the changes made under TCJA. Although Section 2303 of the CARES Act changed when an NOL deduction could be taken, IRS determined it did not change the audit risk associated with the issues on the loss year. We continue to verify the accuracy of requests for refund as they are received, processed, and evaluated for audit potential. We also verify the accuracy of NOLs as part of the examination of a loss year return or when included as a carryback or carryforward.

**Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139  
That Are Based on the CARES Act Net Operating Loss Carryback Provisions**

---

2

During this audit, TIGTA reviewed the results and documentation from 17 closed examination cases and communicated information about an NOL procedural issue. We appreciate TIGTA recognizing our response and the corrective actions taken, including an Interim Guidance Memorandum (IGM) issued on February 7, 2022.

Attached are our comments and proposed actions to your recommendations. If you have any questions, please contact me, or Scott Irick, Director, Examination, Small Business/Self-Employed Division.

Attachment

**Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139  
That Are Based on the CARES Act Net Operating Loss Carryback Provisions**

---

Attachment

**RECOMMENDATION 1:**

The Commissioner, SB/SE Division, should track and monitor examination results for the 25 “still open” examinations of Forms 1120 with reported NOL and an associated Form 1139 reported in Figure 4 of this report, excluding Joint Committee Refund cases which currently have specific monitoring requirements in place.

**CORRECTIVE ACTION:**

We will track and monitor examination results of the 25 “still open” examinations for a maximum period of 18 months.

**IMPLEMENTATION DATE:**

July 15, 2024

**RESPONSIBLE OFFICIAL:**

Director, Examination Quality and Technical Support, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**RECOMMENDATION 2:**

The Commissioner, SB/SE Division, should use the examination results from Recommendation 1 to assess whether to increase the number of examinations of Forms 1120 with reported NOL and an associated Form 1139.

**CORRECTIVE ACTION:**

We will analyze the examination results for the 25 “still open” cases referenced in Recommendation 1. Based on our analysis we will determine if an increase in examinations is warranted for Forms 1120 with a reported NOL and an associated Form 1139 and make recommendations as appropriate.

**IMPLEMENTATION DATE:**

February 15, 2025

**RESPONSIBLE OFFICIAL:**

Director, Examination Quality and Technical Support, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**Compliance Efforts Are Needed to Address Refund Claims Reported on Form 1139  
That Are Based on the CARES Act Net Operating Loss Carryback Provisions**

---

2

**RECOMMENDATION 3:**

The Commissioner, SB/SE Division should review the examination results and computations of proposed net operating loss adjustments for the 25 “still open” Form 1120 examinations with reported NOLs and associated Form 1139, as referenced in Figure 4, excluding Joint Committee Refund cases which currently have specific review requirements in place, to determine if the interim guidance regarding NOLs is being properly followed.

**CORRECTIVE ACTION:**

We will review the examination results and computations of the 25 “still open” examinations for a maximum period of 18 months to evaluate if the procedures identified in the IGM, dated February 7, 2022, are being properly followed. Actions will be taken to address deviations, as necessary.

**IMPLEMENTATION DATE:**

July 15, 2024

**RESPONSIBLE OFFICIAL:**

Director, Examination Quality and Technical Support, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

## Appendix IV

### Glossary of Terms

Term	Definition
Audit Information Management System	A computer system used by IRS Examination functions to control returns, input assessments/adjustments to the Master File, and provide management reports.
Business Master File	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.
C Corporation	A corporation that is taxed separately from its owners. The profit of a C corporation is taxed to the corporation when earned and distributed to shareholders as dividends.
Correspondence Imaging System	A system that captures images of correspondence from taxpayers intended for IRS Accounts Management employees. Correspondence includes letters, returned notices, and standard forms which were scanned and electronically routed to Accounts Management employees.
Fiscal Year	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.
Integrated Data Retrieval System	The IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
Internal Revenue Manual	The primary, official source of IRS instructions to staff related to the organization, administration, and operation of the IRS.
Net Operating Loss	The term "net operating loss" means the excess of the allowable deductions (computed with the modifications specified in I.R.C. § 172(d)) over gross income.
Tax Year	A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

## **Appendix V**

### **Abbreviations**

CARES	Coronavirus Aid, Relief, and Economic Security
FY	Fiscal Year
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
LB&I	Large Business and International
NOL	Net Operating Loss
SB/SE	Small Business/Self-Employed
TCJA	Tax Cuts and Jobs Act
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year





**To report fraud, waste, or abuse,  
call our toll-free hotline at:**

(800) 366-4484

**By Web:**

[www.treasury.gov/tigta/](http://www.treasury.gov/tigta/)

**Or Write:**

Treasury Inspector General for Tax Administration

P.O. Box 589

Ben Franklin Station

Washington, D.C. 20044-0589

Information you provide is confidential, and you may remain anonymous.