The TCJA Is Not for Losers
by Stewart Lipeles, Joshua Odintz, Katie Rimpfel, and Matthew Mauney

I. INTRODUCTION

“I’m a loser baby, so why don’t you kill me?”
Beck, Loser.

This article addresses what no company hopes to experience — a downturn in business. Although the U.S. economy has been doing very well for quite some time, the United States will eventually experience another recession. Even if the U.S. economy is generally doing well, certain industries and businesses will nevertheless suffer material losses. Whether the losses are due to a general recession or are industry or business specific, the resulting losses can materially damage the companies that experience them. Losses arise from deductible expenses that would otherwise offset taxable income and represent true economic costs. It is not clear why net operating losses (NOLs) should be treated worse than other costs that the Code permits to offset taxable income, but Congress has historically placed some limits on a taxpayer’s ability to deduct NOLs. The Tax Cuts and Jobs Act (TCJA) imposed a number of new and more onerous rules that

will adversely affect taxpayers with losses. This article addresses how the TCJA handicaps businesses that experience a downturn and end up generating losses.

This article first reviews prior tax legislation enacted to address the impact of the great recession. Next, we discuss key provisions in the TCJA and how these provisions would impact businesses that suffer an economic downturn. Finally, the authors note areas that Congress will need to consider if the economy slips into recession.

II. TAX LEGISLATIVE RESPONSE TO THE GREAT RECESSION

Over 10 years ago, the U.S. and global economies experienced a once-in-a-lifetime recession. The results were catastrophic to businesses and workers. When credit became tight, many businesses needed access to cash to continue day-to-day operations.

Congress stepped in and worked with the Bush and Obama administrations to provide a lifeline to distressed businesses. While the Emergency Economic Stabilization Act of 2008 provided funds for direct outlays to certain financial institutions, the American Recovery and Reinvestment Act of 2009 contained several provisions designed to help struggling businesses. First and potentially most importantly, Congress extended the NOL carryback period for qualifying small businesses. The Tax Cuts and Jobs Act (TCJA) imposed a number of new and more onerous rules that

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elected this benefit. Congress defined a small business for this purpose as an entity that satisfied the gross receipts test for the cash method of accounting under §448(c)⁶ ($15 million or less in gross receipts). A small business could elect to carryback NOLs up to five years. The rule applied to NOLs arising in taxable years beginning after December 31, 2007.

Congress and the administrations were also concerned that businesses were underwater on their debt and wanted to reduce or write off interest and/or principal. A borrower can recognize cancellation of debt income (CODI) under §108 when a lender forgives principal. Congress addressed this issue by permitting taxpayers to work out their debt and defer the timing of the payment of tax on CODI over the 10-year budget window. The assumption was that taxpayers would be in a better position in three to five years and would have sufficient funds over that period to pay the tax on CODI. The cost to the fisc of §108(i) was not the time value of money. The revenue estimators at the Joint Committee on Taxation do not take the time value of money into account when they make their estimates. Rather, the cost was from the credit risk the United States took by deferring the collection of tax because some of the taxpayers would no longer exist or would otherwise be unable to pay the tax at the end of the 10 year revenue window. In addition to §108(i), Congress turned off the applicable high-yield discount obligation (AHYDO) rules for obligations issued between September 1, 2008 and December 31, 2009.

These provisions took into account that businesses earn profits over a business cycle and allow losses or income to be absorbed in earlier or later periods. Arguably, the TCJA fails to recognize this fundamental economic reality, and Congress may need to step in to provide a lifeline to distressed businesses.

III. THE TCJA

A. Introduction

“Annual income twenty pounds, annual expenditure nineteen nineteen six, result misery. Annual income twenty pounds, annual expenditure twenty pound ought and six, result misery.”⁷

The TCJA moved the United States in the direction of a tax regime that taxes businesses on an annual basis, as opposed to taxing the profits of a business over a business cycle. The most notable changes are modifications of the NOL rules, as well as the enactment of §59A (the base erosion and anti-abuse tax (BEAT)) and §951A (the global intangible low-taxed income (GILTI) regime). In this section, we analyze how specific provisions of the TCJA affect a business in a loss position.

B. TCJA Continues Trend of Restrictions on NOLs

Throughout the 100-year history of the NOL, Congress has repeatedly restricted both the amount of the deduction and the years in which the losses can be carried. While Congress has occasionally expanded the NOL deduction,⁸ the overall trend has been toward limiting the benefit of this provision to taxpayers. Most recently, under the TCJA, Congress amended §172 to allow taxpayers to carryforward NOLs for an unlimited number of years, but only to the extent of 80% of taxable income.⁹ Taxpayers are also no longer allowed to carry back NOLs.¹⁰ Before Congress enacted the TCJA, §172 allowed taxpayers a two-year carryback and a 20-year carryforward. For taxable years beginning before August 5, 2007, §172 allowed taxpayers a three-year carryback and a 15-year carryforward. The TCJA did not modify the three-year carryback and five-year carryforward with respect to net capital losses of corporations. As Congress recognized in the American Recovery and Reinvestment Act of 2009, which Congress enacted in response to the Great Recession, distressed taxpayers may need access to cash to survive. Denying taxpayers the ability to carry NOLs back will make it more difficult for some businesses to survive. For those that do survive, the 80-percent limit on the use of NOLs will make it harder for them to invest in their business to compete in an increasingly competitive global economy.

Temporary, full and immediate expensing under the TCJA should lead to more taxpayers being in a loss position. The TCJA included a temporary modification of §168(k) to allow for full and immediate expensing for qualified property acquired and placed into service between September 27, 2017 and December 31, 2022. The 100% cost recovery allowance gradually decreases in the subsequent five-year period, by 20% each year. Taxpayers who accelerate

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⁶ All section references are the Internal Revenue Code of 1986, as amended (Code), and the Treasury regulations thereunder.

⁷ Charles Dickens, David Copperfield, as quoted in H.L. Mencken, A New Dictionary of Quotations, 330 (1942).

⁸ See, e.g., the Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, which established a temporary general five-year carryback period.

⁹ This amendment applies to losses arising in taxable years beginning after December 31, 2017.

¹⁰ This amendment applies to NOLs arising in taxable years ending after December 31, 2017.
their cost recovery under this provision are likely to incur losses subject to the new 80% limitation, potentially decreasing the benefit of immediate expensing.

C. The BEAT Beats NOLs

The BEAT applies to any “applicable taxpayer.” Generally, an applicable taxpayer is a corporate taxpayer which is a member of an “aggregate group” that (i) has $500 million or more of average annual gross receipts during the three prior taxable years; and (ii) has a “base erosion percentage” of three percent or more.\(^{11}\) The BEAT applies to taxable years beginning after December 31, 2017. When it applies, the BEAT imposes a tax equal to 10% of modified taxable income (MTI), reduced by the taxpayer’s regular tax liability. As a result, a taxpayer’s BEAT liability increases if the taxpayer’s MTI increases or regular tax liability decreases. Whether NOLs or credits are or are not allowed for purposes of calculating MTI or regular tax liability can therefore significantly impact a taxpayer’s BEAT liability.

A taxpayer’s MTI is its taxable income, without the benefit of deductions for “base erosion payments” (i.e. “base erosion tax benefits”). The MTI calculation also disregards a portion of the taxpayer’s NOLs, as will be discussed further below. For purposes of the BEAT, a taxpayer calculates its regular tax liability with the benefit of only certain tax credits. The §41 R&D credit does not reduce a taxpayer’s regular tax liability, but a taxpayer’s foreign tax credits (FTCs) do. Other credits partially decrease a taxpayer’s regular tax liability.

Despite its name, the BEAT acts as an alternative minimum tax because the taxpayer ends up paying the higher of its regular tax or the BEAT. Under the rules for calculating the BEAT, a taxpayer could be subject to the BEAT even though the taxpayer has no taxable income for regular tax purposes because its NOLs (or possibly certain tax credits) completely offset its taxable income. Thus, taxpayers with NOLs that are subject to the BEAT will end up with incremental U.S. federal income tax that other taxpayers may not suffer. Yet, taxpayers with NOLs are likely to be the taxpayers that are least able to shoulder this incremental tax burden.

1. Base Erosion Tax Benefits and Payments

Base erosion tax benefits are generally the amount of deductions a taxpayer claims or reductions in gross income arising in connection with base erosion payments. With the exception of newly inverted companies, the cost of goods sold does not result in base erosion tax benefits. To determine a base erosion tax benefit, the taxpayer must determine whether there is an amount paid or accrued to a foreign related party that gives rise to a base erosion payment. A person is foreign for this purpose if the person is not a United States person (as defined by §7701(a)(30), with modifications). A foreign party is related for this purpose if it (i) owns 25% or more of the taxpayer, (ii) is related to the taxpayer or any 25% owner of the taxpayer within the meaning of §267(b) or §707(b), or (iii) is related to the taxpayer for purposes of the transfer pricing provisions under §482. §59A(g)(3) applies the constructive ownership rules of §318 in determining stock ownership, subject to certain modifications. These rules for determining whether parties are related for BEAT purposes are obviously very broad.

A base erosion payment arises when an applicable taxpayer pays or accrues an amount in a transaction with a foreign related party if the transaction is within one of the following four categories:

1. The taxpayer is entitled to deduct the payment;
2. The taxpayer is entitled to amortize or depreciate the property it acquires as a result of the payment;
3. The taxpayer pays or accrues a premium or other consideration for reinsurance that is taken into account under §803(a)(1)(B) or §832(b)(4)(A); or
4. The taxpayer makes a payment to certain expatriated entities or related foreign person that reduces the taxpayer’s gross receipts.\(^{12}\)

In general, the taxpayer calculates its base erosion percentage each year by dividing (1) the aggregate amount of base erosion tax benefits allowed for the year (the “numerator”), by (2) the sum of the aggregate amount of all its deductions allowed for the year, plus certain other base erosion tax benefits allowed for the year (the “denominator”).\(^{13}\)

2. The Base Erosion Percentage and NOLs

As we explain below, base erosion tax benefits are generally deductions or reductions in gross income that result from base erosion payments, but generally do not include payments that increase the cost of goods sold. The numerator does not include deductions which the taxpayer enjoys with respect to payments that fall within an exception to base erosion payments. The numerator also does not include base erosion payments that do not give rise to base erosion tax benefits because of some other exceptions.

The denominator consists of the sum of all deductions the taxpayer is entitled to take under other parts

\(^{11}\) See §59A(e)(1).

\(^{12}\) See Prop. Reg. §1.59A-3(b)(1).

\(^{13}\) See Prop. Reg. §1.59A-2(e)(3).
of the Code and other base erosion tax benefits, with certain exceptions.\textsuperscript{14} The Proposed Regulations generally exclude from the denominator deductions which the taxpayer enjoys with respect to payments that fall within an exception to base erosion payments.\textsuperscript{15} Yet, if the payment qualifies for either the SCM exception, the qualified derivatives payments exception, or the total loss absorbing capacity exception, there are instances where the payment might nonetheless be included in the denominator. More specifically, if the payment also qualifies for the ECI exception (described below) such that it is excluded from the numerator, and is a payment to a foreign related party that is not a member of the taxpayer’s aggregate group, then the Proposed Regulations exclude the payment from the denominator.\textsuperscript{16} At the same time, the Proposed Regulations do not exclude from the denominator deductions which the taxpayer enjoys with respect to base erosion payments that do not give rise to base erosion tax benefits, for example, where the payment is subject to withholding tax under §1441 or §1442.

The Code and the Proposed Regulations also exclude from the denominator NOL carryover deductions under §172, the §245A dividends received deduction for the foreign-source portion of dividends received by domestic corporations from specified 10%-owned foreign corporations, and the §250 deductions with respect to foreign-derived intangible income and global intangible low-taxed income.\textsuperscript{17}

The rule excluding NOLs from the denominator increases the base erosion percentage. As explained above, MTI only takes into account a portion of a taxpayer’s NOLs. The disallowed portion is equal to the amount of the taxpayer’s NOLs, multiplied by the taxpayers base erosion percentage. The mere fact that the taxpayer’s MTI includes a percentage of the taxpayer’s NOLs means that taxpayers with NOLs end up paying more BEAT. The BEAT then hammers NOL companies again by reducing the denominator in the base erosion percentage by the amount of the taxpayer’s NOLs. This formula for calculating the base erosion percentage means that NOL companies will generally also have a higher base erosion percentage, which means that even more NOLs are added back to taxable income for BEAT purposes.

Until the Service issued the Proposed Regulations, it was unclear whether the taxpayer used the base erosion percentage for the current year or the base erosion percentage for the year in which the NOL arose for purposes of determining the amount of the NOLs they had to add back to calculate MTI. The Proposed Regulations provide that the taxpayer must use the base erosion percentage from the year in which the NOL arose or the “vintage year,” rather than the current year.

The decision to use the vintage year to calculate the base erosion percentage is not all bad news. In the short term, this approach provides a surprisingly favorable result because the base erosion percentage for all NOLs the taxpayer accumulated in years prior to the effective date for the BEAT is zero. As a result, none of the NOLs are added back to MTI.

Unfortunately, what one hand giveth, the other more than taketh away. While the Proposed Regulations favorably provide for a BEAT percentage of zero for pre-effective date NOLs, they provide very unfavorable rules for calculating the impact of NOLs. First, the rules provide that NOLs cannot reduce taxable income below zero.\textsuperscript{18} Second, the rules provide that NOLs reduce taxable income before base erosion tax benefits are added back to taxable income.\textsuperscript{19} As the following example in the Proposed Regulations demonstrates, the combination of the limit on the use of NOLs and the ordering rule can deny the taxpayer any benefit from its NOLs.

\textit{Example}

For 2020, domestic corporation (DC) starts with the following facts

<table>
<thead>
<tr>
<th>Gross income</th>
<th>$100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-BEATable deductions</td>
<td>$80</td>
</tr>
<tr>
<td>BEATable deductions</td>
<td>$70</td>
</tr>
<tr>
<td>NOL carryforward</td>
<td>$400</td>
</tr>
<tr>
<td>Regular taxable income</td>
<td>($50 )</td>
</tr>
</tbody>
</table>

DC’s taxable income for regular tax purposes is negative $50 ($100−$80−$70). Because taxable income is already negative, DC cannot use any of its $400 NOL carryforward to reduce its taxable income for BEAT purposes. Then, DC must add back its BEATable deductions of $70, yielding MTI of $20 ($50 + $70).\textsuperscript{20} If the ordering rule were reversed, DC would have MTI of negative $380, or effectively zero. Similarly, the taxpayer would avoid this negative result if the NOL carryforwards could reduce taxable income below zero. The preamble does not address these unfavorable rules and thus does not explain why Treasury determined these rules are appropriate. Similarly, the statute is silent on how to do the calculation.

\textsuperscript{17} See §59A(c)(4)(B); Prop. Reg. §1.59A-2(e)(3)(ii)(A).
\textsuperscript{18} Prop. Reg. §1.59A-3(b)(1).
\textsuperscript{19} Prop. Reg. §1.59A-3(b)(2)(i).
\textsuperscript{20} Prop. Reg. §1.59A-3(c) Ex.1.
Numerous commentators pointed out that the ordering rules in the Proposed Regulations effectively give preference to cash payments of tax over payments of pre-effective date NOLs. Treasury could address this disparity by allowing a taxpayer to recognize the full value of vintage NOLs by reordering the rules or through a proxy method. The proxy method would reduce the BEAT tax liability by giving the taxpayer credit for the cash tax that would have been paid as regular tax (without the NOL), plus an incremental payment of BEAT for the difference between the regular tax liability (without the NOL) and the BEAT liability.

3. Practical Implications for Taxpayers

The rules for calculating the taxpayer’s base erosion percentage, along with the rule increasing MTI by a portion of the taxpayer’s NOLs, all increase the taxpayer’s potential BEAT exposure. Moreover, as noted above, because the BEAT is an alternative minimum tax, under the rules for calculating the BEAT, a taxpayer could be subject to the BEAT, even though the taxpayer has no taxable income for regular tax purposes because its NOLs (or possibly certain tax credits) completely offset its taxable income. Imposing an incremental alternative minimum tax on any company generating NOLs means that these companies will have fewer resources to invest in their businesses, which will inevitably make it harder for them to recover. The Proposed Regulations compound the problem by providing very unfavorable rules for calculating the impact of the taxpayer’s NOL carryforwards on its BEAT liability. Adding insult to injury, under more traditional alternative minimum taxes, the taxpayer could carryforward the alternative minimum tax paid and use it to offset regular tax in future periods. The BEAT does not contain a similar carryforward provision. As a result, the BEAT is an unrecoverable out-of-pocket expense that will often hit companies that are in the worse position to manage that expense. With the lone exception of the rule providing for a base erosion percentage of zero for pre-effective date NOLs, all of these rules are highly disadvantageous to companies that are already struggling. By the time the next downturn arises, the benefit of having a base erosion percentage of zero for pre-effective date NOLs will be history and taxpayers with NOLs will be in the unfortunate position of dealing with the BEAT when they are least able to do so.

D. GILTI and Losses

Loss companies also suffer under GILTI. The most obvious biases are the exclusion of a loss CFC’s tax basis in qualified business asset investments (QBAI) and FTCs from a U.S. shareholder’s GILTI calculations. Unfortunately, there are also more insidious biases lurking in §951A, §250, and §904 that can impact taxpayers years after they have turned their loss operations around. We discuss these biases in turn below, starting with the QBAI exclusion.

QBAI

Generally, a U.S. shareholder calculates its net deemed tangible income return by aggregating its pro rata share of each CFC’s QBAI and multiplying the aggregate QBAI amount by 10%. The aggregation approach removes any incentive a U.S. shareholder may have to cherry pick where to make foreign investments to minimize its GILTI inclusion. The aggregation approach follows from Congress’s theory that calculating GILTI on an aggregate basis “reflects the interconnected nature of a U.S. corporation’s global operations and is a more accurate way of determining a U.S. corporation’s global intangible income.” Treasury, nevertheless, abandoned the aggregate approach to QBAI in the initial GILTI regulations by excluding a U.S. shareholder’s pro rata share of a CFC’s QBAI for any year that a CFC has a tested loss. The deviation from the aggregate approach appears to be based on a footnote in the Senate’s report on the TCJA discussing the definition of the term “specified tangible property” in §951A(d)(2) (which is property that can result in QBAI) as “any tangible property used in the production of tested income.” The regulations take the position that if the CFC has a tested loss in a given year, then none of its tangible property can be “specified tangible property.” This approach ignores the cyclical nature of business and economic reality that a corporation may not be profitable in any particular year for a variety of reasons.

21 See, e.g., Letter from API to Internal Revenue Service, BEAT “Proxy Method” for Net Operating Loss Treatment (Aug. 1, 2019); Letter from OFII to Internal Revenue Service, Comments on Net Operating Loss (“NOL”) Treatment Under Proposed BEAT Regulations (REG-104259-18) (undated).

22 Letter from HSBC to Federal eRulemaking Portal, IRS REG-104259-18-Proposed Regulations under Section 59A (Feb. 19, 2019). The proxy method would require a taxpayer to determine the proxy tax rate (difference between the regular tax rate and the BEAT rate, multiply the proxy rate by the amount of the NOL used against regular taxable income, and then subtract the proxy regular tax liability from the BEAT. The proxy method would give a taxpayer the full value of its vintage NOL against its BEAT.


24 Reg. §1.951A-1(d)(3).

25 Senate Report states: “Specified tangible property does not include property used in the production of tested loss, so that a CFC that has a tested loss in a taxable year does not have QBAI for the taxable year.” H.R. Rep. No. 115-466, at 642, n.1536 (2017).
even though it is generally profitable and all of its assets are used in an active trade or business that generally produces tested income. If there is an internal or external shock to the supply chain or a related entity and the company must incur significant expenses to compete, the company could experience a down year in between otherwise profitable years. These losses could be due to a flood, a labor strike or any other event that shuts down a facility within the taxpayer’s supply chain. Is it accurate or fair to conclude that such a company is not using the assets to produce tested income due to a lone loss year?\textsuperscript{26} There is certainly precedent for taking a more favorable approach. In other instances, the Code and Treasury Regulations classify property or allocate deductions based on the characteristics of income regardless of whether there was income of that type earned in a particular year. For example, in §951A itself, deductions are allocated to categories of gross income even if there is no income in that particular class during a given year.\textsuperscript{27}

\textbf{Foreign Tax Credits}

A U.S. shareholder that is required to include amounts in income under §951A is entitled to include certain deemed paid foreign taxes in its FTC calculation for taxes that its CFCs have paid or accrued that are properly attributable to tested income.\textsuperscript{28} A U.S. shareholder’s deemed paid taxes for these purposes generally equal 80% of the U.S. shareholder’s inclusion percentage, multiplied by the aggregate “tested foreign income taxes” paid or accrued by its CFCs.\textsuperscript{29} A CFC with a tested loss (which is determined under U.S. federal income tax principles) may nevertheless have paid or accrued foreign taxes as a result, for example, of differences between U.S. federal income tax principles and local tax principles. These differences may be something minor such as a timing mismatch between the foreign tax base and the U.S. tax base that shifts income and/or expense from one year to another. Depreciation schedules, for instance, can be quite different under foreign law. However, proposed regulations under §960 excluded any foreign taxes paid or accrued by a tested loss CFC from the definition of “tested foreign income taxes.”\textsuperscript{30} As a result, the U.S. shareholder will never be entitled to claim a FTC for foreign taxes paid or accrued by a tested loss CFC even if the difference in tax laws results in tested income in a different tax year.\textsuperscript{31}

\textbf{Separate Limitation Losses}

Loss taxpayers also suffer under the §904(f) and §904(g) separate loss limitation (SLL) rules. After applying the expense allocation rules under §861, a taxpayer could have a loss in one of the separate categories of foreign-source income, in its overall foreign-source income, or in its U.S. source income. Section 904(f) and §904(g) provide rules for allocating a loss in a particular basket to offset income in one or more of the other baskets for purposes of determining the taxpayer’s foreign tax credit limitation (FTCL). To the extent a basket of income is offset by a loss in another basket, subsequent income in the loss basket is recharacterized as income in the basket that the prior loss reduced.\textsuperscript{32} These rules were enacted to prevent the double taxation of foreign-source income by recharacterizing income in a later year to permit the use of FTCs that relate to the prior income that was offset by a loss in another basket.\textsuperscript{33} This approach for SLL does not achieve the intended result if the taxpayer cannot carry the relevant FTCs forward.

For example, if a U.S. shareholder’s income in the GILTI basket is reduced by a loss in another basket, the U.S. shareholder’s FTCL in the GILTI basket is reduced, leaving the U.S. shareholder with unused FTCs in the GILTI basket. Taxpayers cannot carry excess FTCs in the GILTI basket forward.\textsuperscript{34} As a result, when income earned in the prior loss basket is recharacterized as GILTI income, the U.S. shareholder is subject to full U.S. tax on the recharacterized income without the ability to offset that tax with the prior unused FTCs. As a result, applying the SLL rules to the GILTI basket is directly counter to the stated purpose for the SLL rules because it subjects foreign income in the GILTI basket to double tax (once by the CFC’s country of tax residency and a second time by the United States). If there is no carryover of FTCs in the GILTI basket, then the GILTI basket should be exempt from the SLL rules. Unfortunately, the TCJA did not amend §904(f) or §904(g) to exclude the GILTI basket from the rules that reduce (or increase) the FTCL in a given basket based on U.S. or foreign losses in another basket,\textsuperscript{35} and Treasury has yet to find a solution.

\textsuperscript{26} Is it fair that a taxpayer in an overall tested loss position cannot use the tested losses in a subsequent profitable year?

\textsuperscript{27} §951A(c)(2)(A)(ii); see also Reg. §1.861-8(d)(6).

\textsuperscript{28} §960(d).

\textsuperscript{29} §960(d)(1).

\textsuperscript{30} Prop. Reg. §1.960-2(c)(5).

\textsuperscript{31} The CFC's foreign taxes can be allocated to the tested income basket even if there is no income in that basket for U.S. federal income tax purposes. Prop. Reg. §1.904-6(a)(1)(iv).

\textsuperscript{32} §904(f)(5)(C).

\textsuperscript{33} T.D. 9371 (Dec. 21, 2017).

\textsuperscript{34} §904(c).

Section 250 Deduction

New §250 reduces a taxpayer’s income by an amount equal to 37.5% of the taxpayer’s foreign-derived intangible income (FDII) plus 50% of the taxpayer’s GILTI inclusion.\(^{36}\) Unfortunately, the deduction under §250 takes a backseat to a taxpayer’s NOL deductions. If the sum of a taxpayer’s FDII and GILTI inclusion exceeds the taxpayer’s taxable income (determined without regard to §250 but otherwise taking into account all deductions, including the deduction for NOLs under §172), then the U.S. shareholder’s FDII and GILTI inclusion are reduced by the excess before calculating the §250 deduction.\(^{37}\) These rules have the effect of requiring a taxpayer to fully utilize its deductible NOLs before it is entitled to the deduction under §250. That means a loss taxpayer could effectively pay up to 21% tax on its GILTI inclusions.

Basis adjustments

Treasury and the IRS are also in the process of drafting regulations to address what basis adjustments, if any, it will require to the tax basis of stock in a tested loss CFC. Treasury had proposed basis adjustment rules under the GILTI proposed regulations, but ultimately decided to incorporate the basis adjustment rules in its forthcoming tax basis guidance.\(^{38}\) In the proposed rules, Treasury stated that, in the absence of any adjustment, inappropriate results may arise in cases where a U.S. shareholder’s pro rata share of the tested loss of one CFC offsets the U.S. shareholder’s pro rata share of the tested income of another CFC in determining the U.S. shareholder’s GILTI inclusion amount. In particular, without a downward basis adjustment a U.S. shareholder disposing of the stock of a tested loss CFC could recognize a second, duplicative benefit from a single economic loss. Therefore, the proposed regulations provided that, when determining gain or loss on the disposition of the stock of a tested loss CFC, the U.S. shareholder’s basis in the stock of the tested loss CFC must be reduced by the cumulative amount of tested losses that were used to offset tested income in determining the U.S. shareholder’s net CFC tested income.

CONCLUSION

“His horse went dead, and his mule went lame, And he lost six cows in a poker game; Then a hurricane came on a Summer day, And blew the house where he lived away; An earthquake came when that was gone, And swallowed the land the house stood on. And then the tax collector came around, And charged him up with the hole in the ground.”\(^{39}\)

There is a consistent theme in the TCJA — the new provisions ignore business cycles and measure income or losses on an annual basis. If the U.S. economy slips into a recession, U.S. companies struggling to compete could lose ground to their non-U.S. competitors because the TCJA subjects them to incremental tax costs related to their NOLs. These consequences run directly counter to the TCJA’s primary objective of promoting US investment and growth. Deprived of necessary assets, loss companies may not be in a position to invest and could lose further ground to non-U.S. competitors. Thus, if the U.S. economy experiences a recession, as it inevitably will, Congress may feel compelled to amend the BEAT and GILTI to provide for carryforwards, or soften the adverse impact of these rules on both loss taxpayers and the overall economy. In an economic downturn, loss companies may not be able to shoulder the cost of permanently losing the benefit of their NOLs. Moreover, Congress may not want to put them in that position. To make these changes, Congress will have to find revenue offsets or allow the deficit to climb at a time when Treasury may be facing significantly greater challenges than today’s generally favorable economy presents.

\(^{36}\) §250(a)(1).

\(^{37}\) §250(a)(2).


\(^{39}\) Author unidentified HL Mencken, A New Dictionary of Quotations 1179 (1942).