<u>Proposed NOL White Paper – DRAFT Outline – 6-10-19</u>

The Finnigan – Combined Filing Work Group has discussed the drafting of a white paper on the subject of sharing net operating losses and NOL deductions. MTC staff prepared the draft outline below for discussion by the group.

<u>Purpose</u>:

The majority of states allow corporations filing a combined or consolidated return to share state losses and state NOL deductions. There must be limits on that sharing to avoid abuse and trafficking of losses. This paper seeks to determine if it would be beneficial for the MTC to recommend certain statutory language or guidelines for limiting the sharing of state losses and state NOLs for these purposes.

<u>Proposed Outline</u>:

I. Introduction – Background
    a. Policy reasons for allowing NOL deductions, generally.
    b. Federal NOL treatment, generally – including TCJA changes.
    c. Overview of federal consolidated filing, generally, including:
        i. Eliminations
        ii. Tax attributes
        iii. Sharing of NOLs
        iv. Succession to NOLs under IRC 381
        (NOTE – federal limitations will be discussed in a separate section.)
    d. Separate versus combined filing—fundamental principles:
        i. Transfer pricing
        ii. Unitary business principle
    e. Joyce versus Finnigan

f. Use of allocation and apportionment to determine the state income and loss – generally, including:

    i. Nature of apportionable and nonapportionable income

    ii. Separate-entity versus single-entity approach

g. Summary of differences in the method of computing state taxable income or loss on a combined or consolidated basis and the reasons those differences may matter.

II. Summary of Limitations on Federal NOL Deductions.

a. Sec. 382.

b. SRLY rules.

c. Other

III. Overview of Existing State Rules for Loss Sharing, NOL Sharing, and Limitations

a. Does the state allow or require combined filing?

b. Does the state allow federal-style consolidated filing?

c. Does the state follow Finnigan or Joyce?

d. Does the state allow members of the combined filing group to offset state net operating losses against net operating income and if so, how (pre-apportioned or post-separate entity apportionment)?

e. Does the state allow sharing of state computed NOL carryovers, so that the members or the group may take any part of the carryover as a deduction against their state income?

f. Does the state require the state NOL carryover to be computed on a post-apportioned basis (so that the apportionment factor in the year of the net operating loss determines the amount that can be used in carryover years)?

g. Does the state conform, explicitly or implicitly, to federal limitations on NOL deductions including IRC 382 and the SRLY limitations?

h. What other limits does the state impose on the ability of the group to share state NOLs?
    i. Entering member may not bring in any NOL.
    ii. Entering member may bring in a state NOL but may only use it to offset the state income of that member (other than SRLY limitations).
    iii. Group may not use any state NOL attributed to exiting member (other than SRLY limitation)
    iv. Other:
        1. Limitations on use of NOLs from non-apportionable losses.
        2. Limitations on use by members who are not unitary.
        3. Etc.

i. How are state NOL carryover's tracked by entity?
    i. Using separate-entity apportionment.
    ii. Using federal-style tracking (the apportioned loss of the group is allocated among the members that had separate company losses and used on a FIFO basis).

j. Does the state conform to the new 80% cap on NOL deductions under the TCJA?

k. Does the state conform to IRC 163(j)'s limitation on interest expense and carryover of the interest deduction (and the limitation on that deduction under IRC 382)?

IV. Comparative Examples of Sharing or not Sharing Losses and NOL Deductions and Limitations

a. No sharing – separate-entity determination of income and loss and separate entity use of NOLs.

b. Sharing of losses but not NOL deductions.

c. Federal limitations and tracking.

d. Other state law limitations and tracking.

V. Challenges and Controversies

a. Survey of challenges or problems administering NOLs from reported sources.
b. Input from administrators, taxpayers, and practitioners.

VI. Conclusions

a. Do existing state rules create administrative and compliance burdens that could be reduced by adopting more uniform provisions.
b. Are certain rules relatively easier/harder to administer or comply with.
c. Other