Office of Chief Counsel
Internal Revenue Service

memorandum

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JEBudde

date: JANUARY 10, 2001

to: [redacted], Team Manager, Group [redacted]
Attn: [redacted]

from: RICHARD E. TROGOLO
Associate Area Counsel (HMT)
Cincinnati, OH

subject: [redacted]
Adjustments to NOL Carryover
SRLY Context

Issue

Is the taxpayer allowed to make computational corrections to its [redacted] and [redacted] tax returns which will change the amount of the NOL carryforward to [redacted] when the [redacted] and [redacted] tax returns are now closed by the statute of limitations?

Conclusion

Yes. The taxpayer (and the government) is allowed to make computational corrections which will change the amount of the NOL carryforward for items affecting a prior year tax return even though those tax returns are now closed by the statute of limitations. The consolidated return provisions must be respected for the SRLY NOLs, but those provisions do not prohibit computational corrections to the NOLs.

Background

You are currently examining [redacted]'s ([redacted]) [redacted] and [redacted] tax returns. The statute of limitations for these years remains open, but the statute for [redacted] and prior years has closed. Just prior to the expiration of the [redacted] statute, on [redacted], the taxpayer filed a Form 1120X for [redacted]. The taxpayer seeks to claim a loss on the abandonment of various assets pursuant to [redacted]. The taxpayer also timely filed numerous "informal claims" for [redacted] and [redacted]. If you allow the claims, the taxpayer will obtain a larger NOLs carry forward. In your request to this office, you ask if the taxpayer can make positive or negative

adjustments to the loss amount in these closed years which will ultimately increase the NOL available in the current, open, years.

The taxpayer files a consolidated tax return which includes the operating results for many entities. Your request to this office states that the taxpayer made two acquisitions of previously unrelated companies which might affect the analysis of the issue. In [redacted], [redacted] acquired [redacted] ([redacted]). When acquired, [redacted] had a NOL of $[redacted] most of which resulted from a [redacted] [redacted] deduction [redacted]. In [redacted], [redacted] acquired [redacted] ([redacted]) which also had a NOL, $[redacted], from [redacted]. Both [redacted] and [redacted] continue to incur losses so none of their accumulated NOLs has been used. You also stated that the losses of the acquired companies have not been combined with the losses for the consolidated group. The refund claims do not seek to combine the two.

Analysis

Section 6511(a), the general rule for the statute of limitations, provides that the taxpayer must file his claim for credit or refund of an overpayment of tax within three years from the time the return was filed or two years from the time the tax was paid, whichever of such periods is the later. There is no dispute that the taxpayer filed his claims timely.

Special rules apply to determine the limitation period for NOL carrybacks. Section 6511(d)(2) provides that if the refund claim relates to an overpayment attributable to an NOL carryback, in lieu of the three year period of limitation prescribed in section 6511(a), the period of limitation is the three year period for the loss year, as opposed to the carryback year.

Section 172(a), titled, "Net Operating Loss Deduction", provides that there shall be allowed as a deduction for the taxable year an amount equal to the aggregate of: (1) the net operating loss carryovers to such year; plus (2) the net operating loss carrybacks to such year. Section 172(b)(2) provides that the entire amount of the net operating loss for any taxable year shall be carried to the earliest of the taxable years to which such loss may be carried -- usually 15

years.

Sections 172 and 6511 interact to allow the NOL generated in one year to be applied in a different year. The statutes contain three terms: "net operating loss," "net operating loss carryover (or carryback)," and "net operating loss deduction" and provide a three step approach in computing a net operating loss deduction:

(1) Compute the net operating loss for any preceding taxable year from which a net operating loss may be carried over to such taxable year.

(2) Compute the net operating loss carryovers to such taxable year from such preceding taxable years.

(3) Add such net operating loss carryovers in order to determine the net operating loss deduction for such taxable year. Treas. Reg. § 1.172-1(b). Thus, when an NOL deduction is made up entirely of carryovers from prior loss years, the relevant year for statute of limitations purposes is the year in which the deduction is eventually taken, not the loss years.

The taxpayer recently discovered additional items which would change the amount of the [redacted], [redacted], and [redacted] refund claim. The additional items are of the same kind as were on the original refund claim. Some of the newly discovered items reduce the amount of the refund, and other items increase the amount of the refund claim. The net change in the refund, itself, is relatively small, but the changes will increase the amount of the NOL carryforward. All of these changes can fairly be characterized as computational adjustments in that they do not present new theories for a refund.

Generally, the Courts and the IRS have allowed the taxpayer, or the government, to make these adjustments to the NOL. In an early case, Lewis v. Reynolds, 284 U.S. 281 (1932) the Supreme Court held that in determining whether there has been an overpayment which may be refunded or credited, the correct tax should be calculated on the basis upon which the taxpayer filed his return, taking into consideration all items increasing and decreasing net income, regardless of the statute of limitations. The tax actually paid may be refunded or credited to the extent of the overpayment represented by the allowable items covered by timely claims when claims are

necessary. In Keefe v. Commissioner, 15 TC 947, 955-56 (1950) acq. 1951-1 CB 2, the Tax Court held that in computing the taxpayer's NOL, the taxpayer could make adjustments to a prior year tax return which was closed by the statute of limitations. The issue before the Court was whether the Court had jurisdiction to determine the overpayment which the Court decided in the affirmative. The same conclusion was reached in the following cases: State Farming Co. v. Commissioner, 40 T.C. 774 (1963)(IRS changed NOL); ABKCO Industries v. Commissioner, 56 T.C. 1083 (1971), aff'd on other grounds, 482 F.2d 150 (3d Cir. 1973) (IRS initiated change). Clearly, the case law supports allowing these adjustments.

The IRS has published guidance which allows these kinds of adjustments. Rev. Rul. 56-285, 1956-1 CB 134 and more recently Rev. Rul. 74-61, 1974-1 C.B. 239, state that adjustments can be made to taxable income for any base period NOL year, that is barred by the statute of limitations for assessment or refund, to arrive at the correct taxable income for year at issue. Rev. Rul. 81-88, 1981-11 I.R.B. 48 (March 16, 1981), discusses a similar issue. Situation 2 in the revenue ruling
involves a deduction of 220x dollars that the taxpayer failed to take in a closed year. In that year, the taxpayer had taxable income of 100x dollars. The issue was whether the taxpayer could use the deduction of 220x dollars to generate a net operating loss that could be carried forward to an open year. The ruling concludes that the taxpayer can use the deduction of 220x dollars to generate a net operating loss carryforward of 120x dollars. As stated in the ruling, section 6511(b) only limits refunds or credits for years in which the period of limitations has expired; it has no application to the correction of a NOL in a year in which the period of limitations has expired, for purposes of carrying the NOL to an open year.

We are convinced based on the court cases cited above and the cited revenue rulings that "taxable income" in section 172(b)(2) means correct taxable income as opposed to reported taxable income and the taxpayer can make the computational adjustments at issue.

The SRLY Aspect

Your request indicates that significant portions of the NOL carryforward were generated by [redacted] and [redacted] when these companies were operating independent of

[redacted]. In a recent telephone conversation, you advised us that your current request does not seek advice concerning the extent to which the net operating losses reported on the separate tax returns of the acquired companies can be used on the [redacted] and [redacted] consolidated tax returns. Any such request for advice will be made at a later time. Instead, your request asks if the rules concerning adjustments to NOLs, described in the preceding pages, change if the taxpayer files a consolidated tax return and has added new members to the group.

We have reviewed the consolidated net operating loss regulations found in Treas. Reg. §§ 1-1502-21, 1-1502-21A, and 1-1502-21T and find no statements which address the specific issue identified above. These regulations, with their different effective dates, provide the most specific regulations for the consolidated net operating losses. Unfortunately, those regulations do not address this issue. Consequently, we believe the general principles described above apply in the consolidated tax return context. As such, we conclude that the taxpayer may correct its NOL computation.

A copy of this memorandum will be sent to the National office for 10 day post-review. Should you have any questions, please contact John E. Budde at 513-263-4857.

RICHARD E. TROGOLO
Associate Area Counsel
(Large and Mid-Size Business)

By:_____
JOHN E. BUDDE
Senior Attorney (LMSB)