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Net Operating Loss Carrybacks
(General Fund Taxes -- Income and Franchise Taxes)

[LFB 2019-21 Budget Summary: Page 140, #13]

CURRENT LAW

Under the individual income tax, taxpayers may carry back net operating losses for two tax years and may carry forward net operating losses for up to 20 years.

GOVERNOR

Repeal current law provisions under the individual income tax that allow net operating losses to be carried back for two tax years as an adjustment to federal adjusted gross income (AGI), beginning in tax year 2019. Increase individual income tax collections by an estimated $2,000,000 in 2019-20, $4,100,000 in 2020-21, and $2,000,000 in 2021-22 and 2022-23.

DISCUSSION POINTS

1. Generally, a net operating loss (NOL) results when a taxpayer's business deductions exceed the taxpayer's gross income. A NOL deduction for a tax year may not exceed the amount of the taxpayer's taxable income. However, the taxpayer may carry back or carry forward the amount of the unused deduction to other tax years offsetting taxable income in those years. Under the state individual income tax, the carryback period is two years, and the carryforward period is 20 years. NOL carrybacks are claimed on a separate tax form and typically require the taxpayer to file an amended return.

2. Several reasons exist to allow businesses to carry NOLs into different tax years. Accounting for losses in a single tax year may not accurately reflect a business's overall profitability.

For example, many businesses, such as new businesses and capital intensive industries, are subject to wide fluctuations in earnings year over year, especially when expanding into new products and services. In addition, income for a single business may differ year-to-year for various reasons, such as the business cycle, natural disasters, or energy price fluctuations, and not allowing otherwise deductible expenses to be used in a different tax year may overweigh the importance of profitable years compared to years having losses. Carrying a loss to another tax year can reduce the impact the income tax may have on investment decisions and provide fairer tax treatment across different types of businesses over a multi-year period.

3. Wisconsin adopted its individual income tax treatment of NOLs in 2013 Wisconsin Act 20 in order to mirror federal NOL treatment. However, Wisconsin's NOL treatment no longer mirrors federal NOL treatment due to changes made in the federal Tax Cuts and Jobs Act (P.L. 115-97), adopted in 2017. The federal Act eliminated the carryback allowance in most instances for NOLs occurring in tax years ending after 2017. Also, the federal Act eliminated the 20-year carryforward limitation, thereby allowing NOLs arising after 2017 to be carried forward indefinitely. The federal Act limits the amount of a carryforward NOL that may be deducted in a tax year to 80% of taxable income.

4. One reason not to adopt the federal carryforward treatment is that businesses experiencing large losses in a given year would experience a tax increase, compared to current law, if the business were limited in the amount of NOL it could use to offset taxable income in each year. Conversely, the number of years over which NOLs can be claimed is unlimited, and could extend well beyond the normal business cycle. In addition, Wisconsin cannot fully federalize its treatment of NOLs because Wisconsin taxable income has adjustments to the federal definition of income, which may result in differing loss amounts. Taxpayers with operations in Wisconsin and in another state may have different losses for federal tax purposes than for Wisconsin tax purposes.

5. Eliminating the two-year carryback under the individual income tax would make the tax treatment of business losses comparable to treatment under the corporate income/franchise tax. Under the state corporate income/franchise tax, a net business loss may be carried forward and used to offset income for the following 20 years. State law does not allow net business losses to be carried back under the corporate income/franchise tax.

6. Another reason to eliminate the two-year carryback of NOLs is administrative simplicity. To claim a NOL carryback, taxpayers must file a separate tax form, Form X-NOL. Because the NOL carryback may affect the taxpayer's adjustments to income or tax credits claimed in the carryback year, taxpayers may be required to file amended returns for the affected years.

7. NOL carrybacks generally result in the Department of Revenue issuing refunds to taxpayers, thereby allowing taxpayers to procure refunds they would not otherwise be able to claim in the current year. As a result, eliminating NOL carrybacks would delay taxpayers realizing a tax benefit. However, because taxpayers with business income generally make estimated tax payments, taxpayers with NOLs can adjust their estimated payments to realize the benefit of the NOL carryforward.

8. The Committee could find that allowing losses to be carried forward adequately

addresses the policy rationales listed above and that it is unnecessary and administratively burdensome to allow taxpayers to carry back losses into previous tax years (Alternative 1). By not allowing taxpayers to realize refunds in the current year, this provision would increase individual income tax collections by an estimated $2,000,000 in 2019-20, $4,100,000 in 2020-21, and $2,000,000 in 2021-22 and 2022-23. This provision would not affect current law provisions that allow taxpayers to carry forward net operating losses for up to 20 years. As a result, individual income tax collections would be reduced in future years, as NOLs that could no longer be carried back, instead, would be carried forward. Over time, the revenue gain due to the elimination of loss carrybacks would be offset by the revenue loss due to larger amounts of loss carry forwards.

9. However, carrybacks are more valuable than carryforwards due to the time value of money. Generally, the value of a NOL carryforward should be discounted to account for the uncertainty of when (or if) a business would have taxable income to be offset in the future. By contrast, a carryback may be taken immediately. Allowing net operating losses to be carried back into previous tax years can also provide relief for businesses in periods in which taxable income in current and future years is likely to decrease or decline entirely into a loss, such as a recession or a natural disaster.

10. Last year, this office reviewed the treatment of losses among states with a corporate income/franchise tax. For tax year 2018, eight states allowed losses to be carried back for two years, and one state allowed a three-year carryback. The remaining 35 states and the District of Columbia did not allow NOL carrybacks, including Wisconsin. If the Committee were to amend the bill to, instead, allow losses to be carried back for corporate filers, Wisconsin would be one of ten states to allow loss carrybacks.

11. The Committee could find it beneficial to align the treatment of losses under state law for both the individual income tax and the corporate income/franchise tax by providing for the carryback of losses for two tax years under the corporate income/franchise tax beginning in tax year 2019 (Alternative 2). As discussed, the principal effect of allowing a loss to be carried back is not to increase the overall amount of deductions, but rather to change the timing of when they are claimed. The fiscal effect would be from shifting deductions from future years for use as an immediate tax refund. It is estimated that Alternative 2 would reduce tax revenues by $107,600,000 GPR-Tax and $636,000 SEG-REV in 2019-20 and $69,100,000 GPR-Tax and $409,000 SEG-REV in 2020-21. The loss of tax revenue would decrease to $51,500,000 GPR-Tax and $305,000 SEG-REV in 2021-22 and the annual fiscal effect would continue to decrease thereafter. The segregated revenue is the economic development surcharge imposed upon C corporations and tax-option (S) corporations, the proceeds of which are deposited into the economic development fund and pay for the programs and operations of the Wisconsin Economic Development Corporation (WEDC).

12. However, Alternative 2 would further distance state law from the treatment of losses under federal law.

13. Under current law, the primary source of WEDC's funding is from the segregated economic development fund. In addition, WEDC receives a sum sufficient GPR appropriation that is capped at $16,512,500, annually. If the Committee chose to adopt Alternative 2, estimated expenditures from WEDC's SEG appropriation would decrease by $636,000 in 2019-20 and $409,000 in 2020-21. Estimated GPR expenditures would increase by the same amount.

ALTERNATIVES

1. Approve the Governor's recommendation to repeal current law provisions under the individual income tax that allow net operating losses to be carried back for two tax years as an adjustment to federal AGI, beginning in tax year 2019. Compared to current law, this provision would increase individual income tax collections by an estimated $2,000,000 in 2019-20 and $4,100,000 in 2020-21.

ALT 1	**Change to**	
	Base	**Bill**
GPR-Tax	$6,100,000	$0

2. Instead of the Governor's recommendation, modify current law to allow claimants under the corporate income/franchise tax to carryback net business losses for two tax years, beginning in tax year 2019. Compared to current law, reduce estimated corporate income/franchise tax collections by $107,600,000 in 2019-20 and $69,100,000 in 2020-21. Reduce estimated economic development surcharge revenues by $636,000 SEG-REV in 2019-20 and $409,000 SEG-REV in 2020-21. Reduce estimated expenditures in WEDC's SEG appropriation from the economic development fund for operations and programs by $636,000 in 2019-20 and $409,000 in 2020-21, and increase estimated expenditures in WEDC's sum sufficient GPR appropriation for operations and programs by the same amount.

ALT 2	**Change to**	
	Base	**Bill**
General Fund Taxes		
GPR-Tax	- $176,700,000	- $182,800,000
SEG-REV	-1,045,000	-1,045,000
WEDC		
GPR	$1,045,000	$1,045,000
SEG	-1,045,000	-1,045,000

3. Take no action.

ALT 2	**Change to**	
	Base	**Bill**
GPR-Tax	$0	- $6,100,000

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