Treasury Inspector General for Tax Administration

Office of Audit

Recovery Act

THE IMPLEMENTATION OF THE FIVE-YEAR NET OPERATING LOSS CARRYBACK CLAIM PROVISIONS WERE GENERALLY EFFECTIVE

Issued on June 14, 2010

Highlights

Highlights of Report Number: 2010-41-070 to the Internal Revenue Service Commissioner for the Wage and Investment Division and the Small Business/ Self-Employed Division.

IMPACT ON TAXPAYERS

The American Recovery and Reinvestment Act of 2009 (Recovery Act) was passed to provide relief for businesses suffering current economic hardships by allowing eligible taxpayers to carry back a Tax Year 2008 Net Operating Loss (NOL) to the five prior tax years. The Worker, Homeownership, and Business Assistance Act (WHBAA), enacted in November 2009, expanded and extended these NOL benefits.

The Internal Revenue Service's (IRS) implementation of these acts and its ability to timely process associated refunds affects thousands of taxpayers. By the end of Calendar Year 2009, the IRS had processed Recovery Act NOL carryback claims for approximately 44,000 taxpayers totaling more than $3 billion. The Joint Committee on Taxation estimated the initial costs of the WHBAA extended carryback provision to be up to $33 billion.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether the IRS provided adequate information to taxpayers related to Recovery Act and WHBAA carryback claims and whether the IRS correctly applied the laws' provisions when processing these claims.

WHAT TIGTA FOUND

Despite the fact that the Recovery Act was enacted during the filing season, the IRS helped foster compliance with the extended NOL carryback provisions by issuing timely and clear guidance to taxpayers. The IRS also issued press releases reminding taxpayers of upcoming deadlines. When TIGTA identified a press release that caused confusion regarding due dates for certain taxpayers making an election, the IRS quickly clarified the information in a revised press release.

In most cases, the IRS effectively processed the carryback claims. It developed an automated tool to ensure taxpayers met the small business requirement ($15 million in gross receipts on average) of the Recovery Act extended NOL carryback provision. There were some programming limitations in the tool; however, only a minimal number of claims were affected.

While some taxpayers received refunds even though primary or flow-through (partnership and S Corporation) returns were not processed or not filed, these problems were not significant in terms of numbers or dollars.

The IRS developed procedures to identify whether Troubled Asset Relief Program recipients inappropriately claimed the extended carryback under the WHBAA. Employer Identification Numbers are cross-referenced to a list of Troubled Asset Relief Program recipients. If the Employer Identification Number on a claim appears on the Troubled Asset Relief Program fund list, the claim is rejected.

One change based on the WHBAA that was not timely incorporated into forms and publications was that NOLs carried back to the 5^{th} year are limited to 50 percent of the taxable income for that year. IRS officials made this change after TIGTA brought it to their attention. TIGTA also found that some claims were processed even though they exceeded the 50 percent limitation. Based on our review, the IRS promptly issued an alert to its employees.

WHAT TIGTA RECOMMENDED

TIGTA made no recommendations in the report. IRS management agreed with the information in the report.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

http://www.treas.gov/tigta/auditreports/2010reports/201041070fr.pdf.

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