



Federal Tax ADVISORY ■

OCTOBER 1, 2019

NOL Regulations Proposed

Treasury has proposed regulations under Section 382(h)(6). [84 FR 47455](#). That section addresses built-in income and deduction items of a loss corporation and how they interact with a Section 382 limitation on the utilization of losses after an ownership change.

In general, if the loss corporation recognizes a built-in loss in the five years after an ownership change, that loss can be subject to the Section 382 deduction limitation, just as if it were a net operating loss (NOL). But if it recognized a built-in gain during that period, the gain can increase the amount of deductible NOLs.

In [Notice 2003-65](#), the IRS created two safe harbors for how to extend those principles to income and deduction items. For loss corporations with built-in gains in assets and operating income, the preferable choice has been the Section 338 approach, which allows the corporation to treat its foregone depreciation as built-in gain. The foregone depreciation is the difference between the actual depreciation and the depreciation if a Section 338 election had been made at the change date.

On the other hand, the so-called 1374 method is mostly used by corporations with built-in losses. And if they recognize any taxable discharge of indebtedness income in the first year after the change date, that amount will be treated as built-in gain and increase their NOL usage.

The most important feature of the proposal is to eliminate the 338 approach. Many objections will be lodged with Treasury about this change, and it may not hold. Meanwhile, Notice 2003-65 remains in effect, and taxpayers can use it.

For more information, please contact [Jack Cummings](#) at 919.862.2302.

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