Treasury Inspector General for Tax Administration

Inspections and Evaluations

Highlights

Highlights of Report Number: 2016-IE-R002 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement, and Deputy Commissioner for Operations Support.

WHY TIGTA DID THIS STUDY

This project was initiated because of the increasing percentage of corporation returns filed reporting net operating losses and the potential impact of those net operating losses as carryforwards on future Federal corporation tax revenues. In Processing Year 2010, 45.3 percent of corporations filed returns claiming net operating losses of $722.4 billion incurred in the Great Recession. In Processing Year 2012, corporate returns reported $1.96 trillion net operating loss carryforwards available to offset future income tax. The objective was to evaluate IRS plans, activities, and programs to administrate the tax laws for corporate net operating losses and net operating loss carryovers.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Chief Financial Officer include in the unaudited information for the IRS financial statements the amount, net present value, and description of the corporate net operating loss carryforward amounts' impact on future corporate tax revenues.

In their response to the report, IRS officials disagreed with our recommendation citing the disclosure is not required by Federal accounting standards, it is unclear the value of such a disclosure, and the potential costs. TIGTA continues to believe that due to the material effect of net operating loss carryforwards on future corporate tax revenues, disclosure is warranted.

Issued on October 13, 2015

THE INTERNAL REVENUE SERVICE ADMINISTERED CORPORATE NET OPERATING LOSSES EFFICIENTLY AND EFFECTIVELY; HOWEVER, FINANCIAL REPORTING COULD BE IMPROVED

IMPACT ON TAXPAYERS

A corporate net operating loss occurs when a corporation's allowable tax deductions exceed its gross income for the year. This normally occurs when a corporation is subject to losses due to business and economic conditions, but can also occur when a corporation attempts to utilize corporate losses through aggressive tax planning. TIGTA found no evidence of the widespread or systematic abuse of corporate net operating losses based on IRS data and information reviewed.

WHAT TIGTA FOUND

TIGTA found the IRS has two significant responsibilities in administrating net operating losses in accordance with established tax policies. First, the IRS receives the claims for net operating loss carrybacks and must expedite their processing to ensure that refunds are timely issued to avoid paying unnecessary interest. Between Processing Years 2007 and 2010, the IRS became more efficient in reducing the percentage of interest paid during the period of increasing carryback return volumes. Second, the IRS has processes and procedures to determine the validity of loss claims and to ensure that net operating loss carryforwards are taken in accordance with legal guidelines.

TIGTA estimates that the $1.96 trillion in net operating loss carryforwards reported in 2012 have a net present value between $371 billion and $414 billion in reduced future corporate tax revenue. However, this information is not readily available in Government information sources and is material to future tax revenues.

READ THE FULL REPORT

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

http://www.treasury.gov/tigta/iereports/2016reports/2016ier002fr.pdf